CORPORATE FRAUDS: A Legal Analysis of Their Causes and a Closer Look at the Regulatory Framework of Corporate Laws in Kenya.

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Abstract— This work takes up and investigates in general corporate frauds in Kenya Corporation.
The aim of this writing is to give an overview of corporate frauds and demonstrate how the practice3 has become rampant and how it should be contained. Further research has led me to believe that with the recent development trends in Kenya, soon or later shareholders will learn not to invest in corporate shares.

The work is divided into 5 Chapters; Chapter 1 is an introductory chapter, which gives an overview of the problem. In Chapter 2, corporate offences in their contemporary and historical forms are bought to the limelight. Chapter 3 is largely an account for the existence of corporate fraud. Chapter 4 is an explanation of the way in which the sate responds to corporate fraud. In the chapter the current modes of regulation and punishment are critically looked at. Chapter 5 is a brief concluding chapter where the current provisions of the Companies Act cap 5 is a brief concluding chapter where the current provisions of the Companies Act cap 486 are closely looked at in a critical manner. The necessary recommendations are also posited in the chapter.
This I tried to do and it is my wish to point out that the work has not exhausted all that there is to know as regards the corporate frauds that are perpetrated by corporate entities and therefore, it is just acts as a stepping stone as the reader gets deep down in study. In understanding that it's a common ground that the law cannot be interpreted in its entity while trying to define what is or is not fraud.

Index Terms— Corporate Frauds, Corruption, Financial statement Frauds, Insurance Frauds, Tax Evasion,

CHAPTER 1
INTRODUCTION

The nature and characteristics of corporate crime in Kenya poses special problems for the enforcement machinery and have far-reaching implications for the containment strategy.
A corporation has been defined as an indigenous device for obtaining individual profit without individual responsibility.[1] There is the difficulty of defining the prescribed behavior of fair notice generally applicable to criminal legislation .the rel4evant Kenyan status rarely provide a dividing line between what is illegal ,what is unethical but legal ,and what is sometimes considered legitimate 'beating ' or taking advantage of the system .
These uncertainties as to the kings of conduct that are illegal have resulted in lukewarm responses from the enforcement agencies or courts.[2]The term corporate, crime encompasses a variety of crimes. Many only bear a superficial resemblance to each other.
This has frustrated the establishment of a coherent set of guidelines for dealing with such an agglomeration of different social offences .the perpetrators of corporate crime are single individuals or groups of individuals.[3] If the principal violator is the corporation, the effective enforcement and punishment through the imposition of criminal penalty becomes difficulty. In most cases, corporate crimes have multi victims and socio-economic regulation with criminal sanctions poses a real dilemma for society and thus the need to understand its nature and how to contain it.[4]
Uncontrolled economic fluctuations mean that business persons facing bankruptcy often resort to swindling or fraud. A society, which enjoins morality on such narrow self-interested basis as 'honesty is the best policy 'and which generally upholds the principle of 'each man for himself', does not encourage its respectable members to accept misfortune. In a society where the ostentatious display of wealth is encouraged and where the wealthy ignore the social costs of accumulation there is a relative indifference to the illegality of methods of profits maximization like the adulterations of food. There will be the same indifference practice of manipulating stock prices and issuing worthless shares.
These are classed corporate crimes because:

> *"They are harmful to the regular progress of capitalization and consequently are threatened with penalties. the punishment of the adulterations of food stuff on the contrary is a consequence of the opposition of the consumers to one of the harmful effects of the system"*[5]

One of the movements with which muckraking was articulated was progressivism. this concerned not with the elimination of capitalism but in the taming of evident excesses of individual capitalists .it was within the progressive tradition that the sociologist Edward A. Ross, in 1907, identified the 'criminal' as:

> *" The director who speculates in the securities of his corporation, as well as the director who lend his depositors` money to himself under divers of corporate*

[1] A Bierre, The Devils Dictionary (Cambridge University Press, New York 1958) page 1
[2] There are no specific provisions in the Companies Act Cap 486 Laws of Kenya on how corporations should be punished.
[3] Geis, G and MEIR, R.F Corporate Fraud: Offences in business, political and the profession (The Free Press, New York ,1997) page 27.
[4] See generally, Barro, R.J (ed) Modern Business Cycle (Harvard University Press, Cambridge,1989)
[5] Supra footnote3

aliases is a criminal. The same applies to the railroad official who grants a secret rebate for his private graft, as well as the builder who hires walking delegates to harass his rival with causeless strikes. The same is also true of the labor leader who instigates a strike in order to be paid for calling it off and the publisher who bribes his textbooks into schools".[6]

A great deal of evidence now suggests that corporate crime hurts, kills, misappropriates, pollutes, deceives, defrauds and despoils largely that ordinary crime. Corporate fraud, commercial fraud, and fraud relating to trades description, food hygiene, pensions, health and safety, and securities all widely affect the public. Surprisingly enough, the law, policing investigation, and sentencing in these areas are notably weak in contrast to the treatment of 'conventional crime'. The law is pressing in one direction and other forces are pressing in the opposite direction. In the business, the 'rules of the game 'conflict with the legal rules. A business who wants to obey the law is driven by his competitors to adopt their methods. This is well illustrated by the persistence of commercial bribery in Kenya in spite of the strenuous efforts by business organization to eliminate it.

Embezzlement is usually theft from an employee by an employee is less capable of manipulating social and legal forces in his interest than employer manipulates. As might have been expected, the laws regarding embezzlement were formulated long before laws for the protection of investors and consumers. Thus there are good reasons for suspecting that the differential application of law, the development of different legal categories and distinct enforcement modus *operandi* for "street" and corporate offenders is not rooted in an intrinsic difference in the offences *per se.*

Transparency international has singled out bad corporate governance as the main cause of kenya1s miserable economic performance. An international monetary fund bulletin affirms this by identify particular, official failure to sustain product macroeconomic Policies. There is more over the slow pace of implementation of the structural reform program in the public sector. Investments according to the report have been depressed because of corruption, deteriorating infrastructure, and inefficient parastatal sector.

Kenya`s record of accomplishment in the area of corporate privatization is not a good one. Highly publicized frauds and business failures, demonstrating rampant abuse by directors and managers of trusts placed in them, have plagued the economy. The pressure is on the Kenyan corporate sector to deliver good governance. IMF in its report acknowledges the government`s efforts to reorganize the economy. In the report, they say that the government has achieved a fiscal adjustment against a difficult backdrop of worsening terms of trade, a dearth of external financing and adverse weather conditions.

The Breton Wood institutions blame the government for messing up the country`s internal and external deficit. The following were some of the economic sabotages noted.

- It decided to rescue the state owned National Bank of Kenya, which is still experiencing financial difficulties. Politically connected bad debtors who owned the bank more that 10billion Kenyan Shillings had almost brought the Bank to its knees. This rescue strained fiscal policy and temporarily weakened momentary policy. This has caused investor confidence to wane hence economic growth has continued to decline. The government decided to relax its monetary [policy that was previously cautious because '*liquidity injection was not fully sterilized* '. The recommendation by a government taskforce concluded that the stock of domestic arrears was much more than originally thought .it is also maintained that the arrears reflected weakness in expenditure control in circumnavigation of relevant regulation.
- Kenya`s economy has been experiencing a downward trend. As of now, we are in deep financial doldrums. In the late 90`s ,the shillings by depreciated close to 20% .The External Current Account deficit (excluding official grant) has widened to about 6% of the Gross Domestic Product.[7]
- A poor expert performance and worsening terms of trade have been reflected. An increase in the Capital Accounts Surplus has led to shift in the Overall Balance of Payment Deficit. The figures available for the years 1997 to 2000 exceed 14 billion shillings.[8]
- External arrears have increased to hundreds of millions of dollars as last year.
- Inflation has to been curbed and hence the shillings depreciates further though during the months of January and February it showed signs of standing its ground against the major currencies in the stock market. This can be attributed to a regime change after the December 2002 General Elections.
- The Real Gross Domestic Product growth has slackened to less than 15% as at last year when unemployment was as its toll. Since the suspension of aid in 1997, Kenya's economy has been going into a steep decline from which it has not showed any signs of recovery.

After the aid freezes, the IMF team that has been called to study the economic performance noted that weak economic growth had

[6] Ross, E.A The 'criminaloid 'Atlantic monthly ,99 January ,44-50, reprinted in Geis and Meir, R.F (eds) White collar crime: offences in Business, Politics, and the Professions (The Free Press, New York,1907) pg3

[7] World Bank Report, World Development Report 2002(The Word Bank, Washington D.C ,2002)

[8] As per the Kenya Auditor General`s 2001 tabled in Parliament in March 2002.

persisted due to slow progress in corporate governance and structural reform. Kenyan economics have observed that, this has had an adverse effect on investor and donor confidence. This has intensified poverty, as well as deteriorating the corporate sector. All these misgivings can be traced to corporate frauds with direct or indirect involvement of the government.

Our understanding of corporate crime and one, which will form a definitional reference point throughout this text, it based on definitions already proposed by Kramer, Box, Schargger and Short, and Clinard and Yeager.[9] Kramer's comments on the concept of corporate crime are a good starting point.

By the concept of 'corporate crime', then we wish to focus attention on criminal acts, which are the result of deliberate decision making of those who occupy positions within the organization as corporate executive or managers. The managers' decisions are organization based. These are made in accordance with the normative goals, standard operating procedures, and cultural norms of the organization and are intended to benefit the corporation itself.[10]

An organization's structure, its culture, and its unquestioned assumptions, as well as its very *modus operandi,* can produce corporate crime. Its understanding requires a shift from a humanist problem to a structural one. These points concerning the organizational responsibility. They simply involve recognition that organizations are the sites of complex relationships, invested with power and authority. Box highlights some of this complexity:

> "The pursuit of organizational goals is deeply implicated in the cause(s) of Corporate crime. However, it is important to realize that these goals are not the manifestation of personal motives cast adrift from organizational moorings. They are also not disembodied acts committed in some metaphysical sense by corporations. Rather organizational goals are what they are perceived to be by officials who have been socialized into the Organizational 'way of life' and strive in a highly coordinated fashion to bring about collectively their realization.''[11]

To speak of organizational goals, or of the normative goals of an organization, should not be read as implying that there necessarily exists any simple identified set of goals within any particular organization. Of course, to refer to organizational goals is important. For example, such a reference begins to separate corporate crime from occupational crime. It may provide a central element in theorizing the origins and nature of corporate crime. It may provide a central element in theorizing the origins and nature of corporate crime. However, the reference to the furtherance or pursuit of organizational goals can be problematic. This is because it is often read as if it conjures up images of perfect rationality on the part of corporations. That is, it implies that corporations have unequivocal sets of goals, are aware of these, that these are consistent, and that they are strategically developed and operationalized. It is worth noting that whether or not corporations are rational actors, they certainly represent themselves as such.

The definition of corporate crime used in this text is then an explicitly inclusive one. That is, throughout the text we discuss as crimes many acts and omissions which have not been the subject of any other form of law. To fail to do otherwise would for us lead into the study of what Braithwaite called "class based administration of criminal justice". This would obscure precisely the most useful insights of Sutherland regarding the class biased development of law and its differential implementation. However, we seek to retain law as a reference point and in doing so, we must be clear that this law is capitalism's law. This does create tensions but we believe that these are manageable while such an approach is legitimate on several grounds.

- First, we have one highly pragmatic rationale for this approach. We access the acts and omissions of companies and organizations simply because in a morally pluralistic society, law remains the most generally accepted standard by which right and wrong are judged.
- Second, we discuss the rubric of crime in the context of acts and omissions that have not been prosecuted successfully in any criminal justice system. That is where no legal verdict has been reached let alone a guilty verdict in a criminal court. Maybe the Goldenberg case[12] will take a debut! We seek to do so using publicly available evidence that it examined both sociologically and through reference to existent legal categories. We attempt to do so with sufficient rigor but our judgment is open to contest. That is our general aim is to bring to bear academic rigor to issues that have not been raised or settled within formal legal *fora.* To refrain from such analyses would mean that some of the most egregious corporate acts and omissions remained free of critical scrutiny through reference to the law. This is indeed technical in state legal systems where it has prevented the trial of a case from receiving a public airing, as is the case with Goldenberg Fraud and the Euro Bank Scandal.
- Third, we reject the claim that to engage in such form of argument is to engage in mere moralizing. On the other hand, we are clear that we discuss fraud within the rubric of crimes a phenomenon for which there exists evidence pointing to some form of legal infraction. We are not discussing our particular version of social harms. On the other hand, we accept that distinction between types of law is both necessary and in many ways motivated through retaining a reference to existent legal categories. We avoid the frequent charge of mere moralizing or moral entrepreneurship.[13] It has been claimed, 'Moral outrage may be good politics but bad science.'[14] Yet as Michalowski and Kramer have rightly noted, using law to define the boundaries of any criminological enterprise is itself 'suffused' with moral choice.[15]

Thus from the foregoing discussion the aims of this text are fourfold.

1) First, we aim to map the different types of corporate offenses both in their contemporary and historical

forms. These tasks seem to us of particular importance given the relative absence of such phenomena from dominant crime, law, and order agendas. We address issues specifically related to this in chapter 2. In the chapter, we discuss the emergence of corporate crimes through a brief overview of the legal creation of the corporation and successive legal attempts to create boundaries around the nature of its legitimate activities. We also attempt to map the forms, scale, and consequences of corporate fraud. We devote a great deal of time and attention to rendering corporate fraud visible. It is of interest to us that we must expend so much effort in this task for readers who are well versed in many corporate concerns.

2) The second aim of this text addressed most explicitly in chapter 3 is an attempt to account for the existence of corporate crime. This is partly an empirical, but largely a theoretical task. Specifically, we address the efforts that have been utilized to explain corporate crime. These draw upon or develop modes of theorizing and explanation developed within the disciplinary confines of criminology. We also assess explanations of corporate crime, which locate its genesis in some aspect of the dominant political economy.

3) Third, we examine the ways in which the state treats and responds to corporate frauds. We critically examine existent literature on the regulations of corporations as well as the statutory provisions that our Legislature has enacted to this end. In chapter 4, we examine current forms of reform and proposals for reform in the ways in which corporate offenders both individuals and the corporate entities are and might be subjected to as a mode of punishment.

4) Each of the three aims or themes, set out here is dealt with explicitly in particular chapters. Their intimately inter-related nature means that their consideration is pervasive. This is particularly the case with the fourth general theme of this text. In a brief concluding chapter, we assess the extent to which corporate fraud either is or can be treated within the confines of the discipline of criminology. This theme runs throughout the text. To pose the question of whether the study of corporate crime through some form of corporate criminology is possible or desirable, in many respects, is the most persuasive theme of the text.

CHAPTER 2

2.0.0 CORPORATE FRAUDS: A closer look at their contemporary and historical forms.

Preliminary.

In this chapter, we will discuss the legal framework in place that favored companies as well as how legislators tried to control corporate activities. We also discuss specific frauds including insurance fraud, tax evasion, and corporate corruption. We take these in seriatim.

AN IMPROVED definition of corporate fraud adopted by the UN congress in 1979 in the Justice System Administration Improvement Act is as follows:

> "An illegal act or as series of acts committed by nonphysical means, or by concealment or guile, to obtain money or property, to avoid payment or loss of money or property or to obtain business or personal advantage."

This definition also encompasses corporate crime, which is defined as "corporate fraud that involves managerial direction, participation or acquiescence in illegal business acts and what have been termed as economic crimes. According to H. Edelhertz, corporate frauds fall into four general categories.

- *Ad hoc violations* committed for one's personal benefit on an episodic basis.
  Examples would be individual tax frauds, credit and frauds, and bankruptcy frauds.
- *Abuse of trust committed* by a fiduciary or trusted agent, or a receipt of a bribe, or favoritism in conferring a benefit. Individual businessmen and governments are all victims of such crimes.
- *Collateral business crimes* committed by businessmen to further their primary legitimate purpose. Such crimes are incidental to an in furtherance of business
  Operations, but not the central purpose of such business operations. Examples would be the bribery of customers" agents, use of false weights and measures and sales misrepresentations with the victims being the public and governments.
- *Confidence tricks committed* for the sole purpose of cheating customers. Such, crimes are often the central activity of the "business" involved. Examples would be charity frauds, land sale frauds, and sale of worthless securities or business opportunities. The victim in most cases is the public.

2.1.0 **Legal development favoring companies.**

In their early stages of development companies, pioneered new areas for trade and governments had interest in supporting these corporate activities. Much later, in the nineteenth century such principles were still at work. The rapid economic changes of industrialization entailed many companies expanding very quickly. There were in the early nineteenth century a growing number of civil actions against companies for compensation where workers had been injured in the most appalling circumstances.

At this time a number of legal doctrines were construed which obviated the possible defenses that were available. These included:

- *Volenti non fir injuria*
- *Contributory negligence*
- *Doctrine of common employment*
- *Doctrine of privity*

The civil law was developed to offer support and protection to corporations. The policy was created on an *ad hoc* basis. Judgments by judgment were delivered not as part of any grand conspiracy but its effects were clear. Companies were not easily found liable for crimes and any frauds that they committed.

2.1.1 Companies and the Criminal Law:

The criminal law as it touched corporations was equally insensitive to the needs of expanding business. However, for the early part of their history, the corporations lay outside the criminal law. "It had no soul to damn and no body to kick"[1] If a crime was committed by the orders of a corporation, criminal proceedings for having thus instigated an offence could only be taken against the separate members in their personal capacities and not against the corporation itself.

In 1701, Lord Holt C.J is reported as having said that a corporation is nor indicatable but the particular members are[2]. This was due to the technical rule that criminal courts expected the prisoner to 'stand at the bar' and did not permit appearance by attorney. [3]

Roman law supported the old idea. They reasoned that as it did not have an actual existence, a corporation could not be guilty of a crime because it could not have a guilty will. Furthermore, even if the legal fiction, which gives to a corporation an imaginary existence, the existence, could only be stretched to give it an imaginary will. Activities that could be consistently ascribed to the fiction thus created must be such as are connected with the purposes for which the corporation was created to accomplish.

A corporation could not therefore commit a crime because any crime would necessarily be *ultra vires* the corporation. Moreover, a corporation is devoid not only of mind but also of body and therefore incapable of receiving the usual punishment. "What? Must they hang the common seal?" asked an advocate in 1682 in the case of R –*VS- City of London*[4]

The proliferation of companies in modern times and the extent of their influence in social life have caused the criminal law to bring them within its jurisdiction. This incorporation within the criminal law has been arguably belated, careless, and unsystematic but it has nevertheless occurred. Turner has noted that: [5]

"Under the commercial developments which the last few generations have witnessed; corporations have become so numerous that there would have been grave public danger in continuing to permit them to enjoy the old immunity."

Mr. Justice Turner followed this reasoning in his preliminary ruling in 1990 in the ***Herald of Free Enterprise case.*** He examined the history of corporate liability and noted[6]that:

> "Since the nineteenth century there has been a huge increase in the numbers and activities of corporations whether nationalized, municipal or commercial whose activities enter the private lives of all or most of us in a diversity of ways. A clear case can be made for imputing to such corporation's social duties including the duty not to offence relevant parts of the criminal law."

The first time corporations were brought within the jurisdiction of the criminal law was for failure to satisfy absolute statutory duties. Courts were not concerned with the problem of finding any *mens rea* in a non-human entity. The terms *mens rea,* literally the 'mental thing' developed from Roman law followed within the criminal law. To this extent, conduct is not criminal unless the mind of the person committing the conduct is blameworthy. In criminal law, there are various types of *mens rea,* ranging from negligence to intention.

Developing commerce required that there should be no serious interruption or damage to parts of the economic infrastructure, legal scholars thought so because it would impede the expedition of all sorts of commercial activities and thus are a cause of financial loss and annoyance to many enterprises. It was in this context that obligations were statutorily imposed on companies, and where the earliest prosecutions against companies would follow if they did not meet those obligations. In R-vs- Birmingham and Gloucester Railway Co, [7] a company was prosecuted for failing to construct connecting arches over a railway line built by it in breach of a duty imposed by the statute, which authorized the incorporation of the company. The defense argued that an indictment would not lie against the company but Mr. Justice Paterson rejected that claim, stating [8] that:

> "*A Corporation may be indicted for breach of duty imposed on it by law, though not for a felony or for crimes involving personal violence as for riots and assaults*".

The prosecution there relied on nonfeasance as the basis for liability. Subsequently judges arbitrarily dismissed the nonfeasance and misfeasance distinction. In R-V- Great North of England Railway Co[9] Lord Denman C.J confirmed that a company could be indicted for misfeasance. Disposing of an argument that it was not necessary to prosecute the company when a culpable individual could be identified and proceeded against, the Lord Chief Justice said:[10]

> "*There can be no effectual means for deterring corporations from an oppressive exercise of power for the purpose of power for the purpose of gain, except the remedy by an indictment against those who truly control it. That is, the corporation acting by its majority and there is no principle which places them beyond the reach of the law for such proceedings*."

During the last quarter of the nineteenth century, the number of prosecutions of companies rose annually. Delivering his opinion in a case in 1880[11], Lord Blackburn stated in passing judgment that a corporation could commit crimes for which it could suitably be prosecuted.

If the criminal liability of corporations was to extend beyond these points, two difficulties had to be overcome. First, a corporation having no social duties was generally unable to form that state of mind, which is required for the mens rea of the crime. The only crimes it could commit were strict liability offences. The second problem was the means by which the "mind" of the corporation could be identifies or ascertained.

In 1944, three cases were decided which were to have lasting effect on this area of law.

Indeed, Welsh has argued[12] that the effect was revolutionary since it established the notion that a company could have an ordinary *mens rea.* The reason for such a dramatic watershed in three decisions all within a few months of each other is certain bur Leigh has suggested [13] that it was in response to violations of wartime regulations. The cases established that a corporation could be guilty of a crime in circumstances where the principles of *vicarious liability* would be not applying.[14] In these decisions, we find the genesis of the doctrine of identification.

The offence in question in the first case **DPP -VS- Kent and Sussex Contractors[15]** was one under the Motor Fuel Rationing Order. The Divisional Court held that a company could commit a crime requiring intent to deceive. Mr. Justice Hamlet stated:[16]

> "*With regard to the liability of a body corporate for…crime…there has been a development in the attitude of the courts arising from the large part played in modern timed by limited liability companies."*

Giving judgment in the same appeal, Lord Caldecote said:[17]

> "The real point which we have to decide is whether a company is capable of an act of will or a state of mind, so as to be able to form an intention to deceive or to have knowledge of the truth or falsity of a statement…. although the directors or general managers of a company are its agents, they are something more. A company is incapable of acting or speaking or event of thinking except in so far as its officers have acted, spoken or thought……the officers are the company for this purpose."

In the second case, R-V- I.C.R Road Haulage Ltd[18] it was held that an indictment would lie against a company for common law conspiracy to defraud. Mr. Justice Stable [19] referring to the decision in **R –vs- Cory Bros.**[20] said," if the matter came before the court today, the result might well be different.'

The last of the trio of cases Moore –VS Bresler[21]followed the earlier decisions and a company was successfully prosecuted for using a document with intent to defraud.

Although the legal decisions in these three cases are far from clear, they manage to surmount the theoretical difficulties of attributing *mens rea* to a company.

2.1.2 The Problem of Discovering the Mind of the Company.

Following the decisions of the 1944 trio of cases, corporate intention was found by treating the *mens rea* of certain employees of the company as the *mens rea* of the company itself. It was not every employee, whose *mens rea* was deemed to be that of the comapny[22]. However, a company has no physical existence and cannot think or act. A fiction has to be applied to convert the acts and thought of a human being and not those of the corporation thereby attributing personality to it. This is known as the *identification principle* and a variety of criteria and phrase for determining whom in a company thinks and acts as that company have been suggested.

In the leading case of **Tesco Supermarkets Ltd –vs- Nathrass[23]** Lord Viscount Dilhorne[24] thought that it would have to be someone.

> "Who is in actual control of the operations of a company or of part of them? He is to be a person who is not responsible to another person in the company for the manner in which he discharges his duties in the sense of being his orders.''

In determining who are the people representing the controlling minds of the corporation a dictum of Lord Denning in H.L. Bolton (Engineering) Co. Ltd –vs- TJ Graham and sons[25] was approved by the House of Lords which held that:

> "A company may in many ways be likened to a human body. It has hands which hold the tools and act in accordance with the directions from the Centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will of the company. Others are directors and managers who represent the directing mind and will of the company and control what it does. The state of mind of these managers is the state of mind of the company and it is treated by the law as such."

This formula does not include all 'manager' since not all such persons represent the directing mind and will of the company and control what is does. The wide and flexible test of the 1944 cases was disapproved and replaced by a far stricter one known as the *controlling officer test*. In any event, it is a question of law whether a person is to be regarded as having acted as the company or merely as the company's servant or agent.[26]

2.2.0 Specific corporate frauds.

Corporate fraud usually takes the form of financial violations. These can be illegal payments, issuing of false statements and information, various transactional offences, and tax violations. The collapse of Kenyan corporations in the past two decades can be attributed to grandiose fraudulent dealings.

2.2.1 INSURANCE FRAUDS- A case study of the Massachusetts experience in the 1990s and the Kenyan experience.

There is widespread agreement that insurance fraud is a major problem in the United States. More than 27% of insurer responding to a recent industrial survey believe that the extent, of fraud in the Private Passengers and Workmen Compensation schemes is high. There is little agreement, however, as to what constitutes Insurance Fraud in the many articles and research papers published on the subject during the past ten years. This ambiguity in defining Insurance Fraud results in widely divergent estimate of the proportions of claims or policy premiums attributable to fraud.

In their annual report for the year 2000, the Coalition Against Insurance Fraud[27] includes a telltale section called *"Pin the Tail on the Estimate."* Estimates of the cost of insurance fraud range from a low of $18 billion by the National Insurance Crime Bureau for *property liability fraud* to a high of $96 billion by conning and com-

panies. These are for all schemes of private market insurance. Generally, C.A.I.F estimates that Insurance fraud costs Americans at least $80 billion annually.[28]

Annual national premiums for property liability Insurance and *life insurance* in 2000

were $300 billion and $435 billion respectively. For a combined $735 billion, this represented 13% for each insurance liability fraud. About one and half million fraudulent insurance claims would be filed each year. However, IN Massachusetts, which accounts for about 6% of the US population, Insurance Fraud Bureau (I.F.B) only receives about 1500 *property liability fraud referrals* per year. This is one sixth of what might be expected.[29]

the vast discrepancies outlined above represent the wide range of meanings that the word "fraud" has in different context rather than of vast amounts of undisclosed or undiscovered fraud that should be prosecuted. Often the adjectives "soft" and "hard" will precede "fraud" to convey a distinction between claims involving exaggerations of damages from real accidents and those claims arising from staged, non-existent, or

unrelated accidents. The position is true in Kenya where doctors, layers, and accountants gang together to defraud insurance companies., though no figures are present to support this proposition, it is quite evident that insurance fraud is rife in Kenya and it is a thriving business for insurance fraudsters, lawyers, an and doctors.

The latter if proved beyond reasonable doubt in a court of law, is certainly a criminal matter. The former may simply be a matter of judgment more suited to civil adjudication or prescription by law or regulation than criminal prosecution. The unrestricted term "fraud" should carry the common connotation that the activity is illegal and hence that prosecution and conviction are potential outcomes of a specific fraud. Accepting that premise allows us to adopt the legal definition of fraud in the insurance context here and to examine the experience of dealing with insurance fraud. In insurance schemes. This is in terms of criminal prosecutions and outcomes. The societal objective of prosecuting insurance fraud, like other crimes, is to both punish and deter offenders and potential offenders from committing future crimes.[30]

Little if any date seems available that can shed light on these and the range of outcome of insurance fraud prosecutions. At the same time, it would be instructive to know one characteristic of those who commit insurance fraud. It would also be of essence to know whether actual prosecution and sentencing of guilty parties deters future offenders.

2.2.2. What Is Insurance Claim Fraud?

At least two definitions of *insurance claim fraud* are in common use. In this text, the term insurance claim fraud is reserved for criminal acts provable beyond reasonable doubt. The term "fraud" is reserved for financial transactions with four properties.[31]

- Intent
- Illegal
- Financial gain
- Falsification

The extremely high estimates of fraud such as fraudulent coning of $96 billion have confused criminal fraud with what many call suspected soft fraud that is at best an abuse of the insurance scheme. This abuse arises in the form of unnecessary and unintended coverage of claims. The vast majority of these situations are characterized as claims with some element of fraud. They are mislabeled as suspected fraud when they should be renamed systematic abuse. For example, auto injury claims in Massachusetts reached level in 2001 where more than 80% of the claims involved the vast sum of dollars in medical treatment for strains and sprains. In Kenya, scheming smart lawyers and doctors fleece insurance companies of money. They come up with fictitious claims amounting to millions of shillings. This is a clear abuse of the insurance compensation system as intended by those wanting to cover the loss of those seriously injured in auto accidents. They are not all fraud despite the fact that most were probably not intended to be covered by the 1995 legislators of the Auto Liability statutes.[32]

Given the large amount of money involved in the strain and sprain or *whiplash auto claims,* economic incentives exist for current service providers to keep the system coverage as it is in the USA. The economic incentives in the system of *auto tort* claims and high *Worker* Compensation benefits can easily encourage claim filing especially when the attorneys are present in numbers. This maximizes the use of the insurance system. The Workmen Compensation scheme in Massachusetts in the late 1980s[33] or the auto bodily liability experience in California in the early 1990s[34] are prime examples of the result of such incentives. In any event, the cast majority of auto strain and sprain claims are the result of discretionary filing of legal claims and the discretionary us and treatment. This has extended beyond that amount that would minimize premiums for subsequent policies. Fraud in the remainder of this text will refer to criminal fraud, also known as planned fraud. In order for an insurance transaction to be considered fraud, it must contain the four elements cited previously. These must be provable beyond reasonable doubt in a court of competent jurisdiction.

In Kenya, there has been a sprawling increase in the numbers of insurance companies, which go under after a short stint in the insurance field. Typical examples include the Kenya National Assurance Corporation, which was brought down systematically to its knees by corporate directors in collusion with well-connected individuals. The company was financially drained until it went under. In the recent past, *Stallion Insurance Company* and *Lakestar Insurance Company* filed for bankruptcy. The clientele of these companies lost their premiums when the

companies went under liquidation. *Stallion Insurance Company* was wound up and *Lakestar Insurance Company* is currently under
receivership. Most of its branches countrywide have been closed down. This is a clear indication that insurance fraud is catching up with the Kenyan clientele at a fast pace. Nobody seems to understand what the insurance industry is up to. Surprisingly not one single director or insurance Company has been successfully prosecuted to act as a living example to potential fraudsters.

2.3.0 CORRUPTION: The corporate perspective.

"Once the camel has stuck its head in the tent, the rest of the body will not be too far behind. (Arab proverb).

2.3.1 What it corruption?

Corruption is a source of concern for governments, entrepreneurs, private individuals, non-governmental organizations, and companies and indeed for society as a whole. In this text, we try to explain why corruption is a source of concern for companies. We explain what corruption is by describing how it occurs. We offer a causal explanation and then we describe how it occurs in corporations and why it is a cause of concern for them.

To propose a definition for a shadowy and changing phenomenon, such as corruption, is always a hazardous exercise. Before attempting the task, it is wise to identify some of the preconditions that characterize its existence. These are:

1. A power or influence that someone has in the exercise of a public or private function, task or responsibility in the service of another.
2. Discretion derived from this power or influence that enables that person to make certain decisions on an exclusive basis.
3. *Certain duties* associated with the position or function in the public office, company, or portfolio, in which the person who has power or influence works or serves.
4. *The incorrect exercise* of that power or influence, or the attempt to cause such incorrect exercise by either the decision-maker or executor himself or another person within or outside the organization.
5. A private benefit for the person performing the corrupt act or for another person, company organization, or political party

The corrupt act may or may not include an appropriation, incorrect use, or harm of the goods or assets of the public office, company, or institution. It usually takes place in the

Rules, in the initial conditions, or in a context of concealed information. This characterization of corruption is not a definition as such. It only seeks to delimit the scope of actions we call corrupt. These include extortion and bribery commissions, gifts, and doubtful favors. It also includes nepotism, favor currying, and favoritism. It can also be illicit use of or sale of insider information, misappropriation or embezzlement of funds and the actions of the kleptomaniac or predatory state, which does not distinguish between what, is public and what is private.

As we have pointed out, corruption is always associated with non-performance of a duty mandate law, regulation, rule, contract or commitment to act always in accordance with the interests of a corporation in which the corrupt person renders his services. This element enables it to be distinguished from other situations in which this illegality does not occur, even though these generate a benefit for the corporation concerned e.g. granting a monopoly, raising barriers to free competition, or drawing up rules that favor certain groups of corporations. However, in a broad sense these situations can also be classified as corruption.

2.3.2 A Descriptive Approach to Corruption.

Corruption comes about by the interaction between citizens or private sector[35]in dealing with the public sector, namely the rulers and the civil servants. Corruption may also come about in dealing between rulers and civil servants.

Citizens come into contact with the other agents in several ways.

1. They receive resources, goods, and services that are provided by the public sector either free of charge or by payment of a price.
2. They also enjoy rights
3. They sell goods and service to the public sector in exchange for money.
4. They pay taxes.
5. They must perform certain duties.

To make collective decisions and manage public affairs, citizens choose certain representatives who are required to act in accordance with the citizen's interests. The rulers' task is to establish a society's legal and institutional framework. The rulers hire certain services of certain citizens, who become civil servants or bureaucrats to help them manage public affairs, in return for remuneration. The rulers direct the administration to the civil servants, and require that they act in accordance with their demands and commands. Usually the private sector through the civil servants accepts the design of the

legal and institutional framework and the establishment of certain basic rights, which they negotiate with the rulers.

In this framework, collective interests are relatively well defined.

1. Commissioned by the citizens, the rules accept the undertaking to develop the legal and institutional framework and govern the administrative apparatus in accordance with their voter interests.

2. The civil servants receive instructions from the rulers and undertaken to manage the government's affairs in accordance with their guidelines.
3. The citizens accept the rules imposed by the rulers an administered by the civil servants, and undertake to pay the taxes that are established.

However, alongside these collective interests, personal or group interests may give rise to situations of corruption.

1. Rulers may use their power to manipulate the legal and institutional framework, thereby generating a benefit or harm for certain citizens from whom they expect to obtain compensation in order to enjoy the benefit or avoid the harm. Such actions need not take on the conventional form of extortion or bribery, although they do come under the broader category of rent seeking and appropriation.
2. Rulers may also manipulate the administrative functions entrusted to the civil servants so that they give rise to those benefits or detriments for citizens who are not beneficiaries of corrupt actions. As in the previous cases, this is possible because some citizens' personal interests do not align with their collective interest. Likewise, citizens as groups will be required to pay their taxes while some citizens may be interested in avoiding their tax obligations.
3. Rulers may intervene in civil servant's appointments, and promotion remuneration thereby creating conditions enabling them to *extract rent* from citizens.

In all these cases, the initiative may arise from the citizens' bribe, or from the rulers' or civil servants' extortion. I practice, this distinction may not be very clear.

So far, we have presented instances of corruption in the public sector's dealings with the private sector. However, corruption may also take place within the private sector, in companies, and not for profit organizations. In this case, the owners designate the managers to perform the management of their organization, wither owners designate the managers to perform the management of their organization, either directly or through employees. This management should be performed in theory, in the interest of the former.[36] Situation of corruption similar to those mentioned above can take place:

1. Outwards, when managers and employees interest with third parties, providing them certain benefits or avoiding certain costs in exchange for a compensation thereby failing in their duty to the company.[37]
2. Outwards, when managers and employees misappropriate the company's assets or funds or when they perform other acts for their own benefit, to the detriment of the company's interests.

Obviously, this description cannot be expansively explained particularly when considering situations that do not fall clearly into any category.[38]

These are indoctrinating situations because they may be concealed and attempts to obtain an illicit advantage may be prevalent. They may also be an expression of friendship or goodwill.

2.3.3 A causal Approach to corruption.

Corruption takes place when the following exist.

1. Discretion granted by law, or made possible by market imperfection giving exclusive rights to rulers or civil servants in making certain decisions. The risk of corruption will therefore be greater.
2. The possibility of obtaining a benefit or avoiding a cost for the private sector and the amount of the benefit or cost. This amount will depend in turn on the corrupt actions "income" and "cost". The income will be greater the mote similar the situation of corruption, the lesser the number and proximity of its substitutes and the greater the restrictions imposed upon the competition. The corrupt actions "cost" for both parties will deepen firstly on the possibilities of inspection and discovery concealing information and secondly on the amount of the penalty.

These conditions are endogenous, as corrupt politicians and civil servants can manipulate them:

1. Increasing the discretion of their actions.
2. Creating opportunities for private profit[39] as well as creating artificial costs for citizens.
3. Reducing the possibilities of investigations and punishment.[40]

This type of behavior is not fortuitous. Extortion and bribery are much more profitable and entail much less risk when they are organized and disseminated. The vertical and horizontal "integration" of corruption reduces the likelihood of being caught and facilitates protection. In addition, corruption is a contagious phenomenon. The other civil servants provide information about opportunities and the means to exploit them, and create advantage and an atmosphere of impunity. In the end, individual corruption may degenerate into a general situation of favor currying, subservience and "protection".

Situation of corruption may also arise in companies. First managers and on a small scale, employees too have a broad margin for discretion because it is not possible to put down in a contract al foreseeable actions, or measure performance with suitable variables.[41] In particular, a person's chances of obtaining an extra ordinary benefit in his dealings with a company will depend, above all on the degree of market power. Private corruption will consequence be greater in sectors that are protected from competition, or have a symmetric product differentiation etc. It is also "likely that the lack of competition pressure will also be felt in the insufficient control and punishment of cases of corruption

2.3.4 The Dimensions of Corruption.

Any action or conduct has a variety of dimensions that enable it to be assessed. We can classify these as economic socio-political and ethical. From the economic viewpoint, Corruption is associated with a long list of aggregate negative effects.

1. Inefficiency in the use of resources, in the form of higher costs and prices and lower outputs, distortions which shift output towards goods services, re-

sources and factors that are not the most suitable considering countries comparative advantages, determination of quality time inappropriately used or wasted. All these lead to a reduction in the growth rate of the countries affected by corruption, insufficient capital formation or capital directed towards uses that are more likely to provide private profit.[42] This causes a lower social return, reduced entry of foreign investments, and ales efficient public spending structure[43]. It can also lead to redistribution of income and wealth, unequal treatment, illicit enrichment of certain groups, and greater inequalities in income distribution. These are obstacles hampering less favored groups in their efforts to progress from their situation. All these are more harmful to small and recently formed and probably more innovative companies, and favor the growth of the underground economy.

2. Structural effects, which give rise to imbalances in the framework in which economic agents act.[44]

In the socio-political area, corruption is seen as a distortion in decision-making processes that creates opportunities for some and creates costs for others; it restricts the scope for citizen's rights. It facilitates opaqueness in actions. It eludes political and legal controls and counterweights and in the long, it undermines the government's legitimacy and even that of the democratic system itself.

Corruption is also an ethical problem. The ruler, civil servant manager or employee who acts against the duties for his position enters situations such as those described above, is acting unjustly to his "*principal"* and is not fulfilling the duties that correspond to his position. Anyone who pays to obtain a benefit or avoid harm is contributing to this unfairness although as we shall see further on this co-operation may be justified in some areas. It is common for this unfairness to effect other people or companies, which suffer the adverse effects of the corrupt action. Harm is also done to the common good as far as the corporation does not contribute to furthering and propagating it.

What ethics adds to the economic and socio-political arguments is the recognition of the harm done by corruption to people and society. This harm arises from a moral learning process that modifies capabilities and conducts. This process consists of the loss of virtues.[45]

The process happens both on a personal level[46] and on a social level. Corrupt people imitate others behavior hence the capacity for social resistance is weakened. When all this is considered, it is clear that the economic criteria cannot be decisive for determining whether corruption is favorable for the company. This is so even from the strict economic viewpoint. This is because corruption like in any other human conduct generates changes in knowledge, abilities, skills, behaviors, values and virtues as a result of which the future can no longer be like the past. When viewed in this light it seems logical that society as a whole and corporations in particular should view the elimination of corruption with concern and declare it very unacceptable.

2.3.5 Corruption and companies

To aid us in the study of corruption in Kenyan companies it may be interesting to classify the possible situations as follows:

1. Corruption to the company's benefit when managers or employees accept extortion or make a bribe to obtain beneficial effects for the company or prevent it from suffering harm. Within this type of corruption, we must distinguish between several situations.
2. Corruption for the benefit of the manager or employee. Here too it is advisable to distinguish between differing situations where the harm to the company is greater or lesser.
3. Corruption for the benefit of the manager or employee based on a real or presumed benefit for the company.

The moral core of corruption lies in the fact that someone acts unfairly and disloyally in his duties with respect to his company, government, department or institution, using his position of responsibility to obtain a benefit. There may also be situations of unfairness with respect to the other party. For example, it may be the case that the corrupt persons cause or threatens to cause the other party an unfair harm if he is not offered compenasation.[47] there may be harm to third parties and to society at large.

The rules for approaching the different situations can be summarized as follows:

1. It is unethical to accept or offer a bribe, or demand extortion, for the reason given above.
2. It is unethical to accept an extortion to obtain something for which one is not entitled.
3. In certain case, it is possible to accept an extortion to obtain something to which one is entitled.
4. Managers and employees must not perform corrupt actions for their own benefits.
   This is because they are failing in the duties corresponding to their position or contract with the company and even more so if these actions cause harm to the company

2.3.6 Corruption: A Source of Concern

There are many reasons why Kenyan companies are or should be concerned about the cases of corruption in which they may be involved. Corruption has directed costs, which may be high as it is an illegal activity. Indeed, for many companies, corruption is seen as a major risk, which may give rise to significant financial costs for companies and for their managers.[48] It may also cause serious damage to their reputation and consequently their ability to generate future profit. Other direct economic costs of corruption include increased spending and decreased efficiency in the use of resources.

However, this is not always the case particularly when the company is subject to extortion, which it can avoid by means of a payment but without any net benefit[49] The same thing happens when the company suffers the consequences of corrupt conduct among its employees or managers.

From a purely economic viewpoint, corruption is profitable when the net discounted value of expected returns exceed present and future expenses. The former is clear but the latter are less precise even when they are limited to economic variables.[50] Thus, the multiplication of causes of corruption may generate increased impunity but also a change in the institutional and legal system. Consequently, a greater chance of being accused prevails, which is also applicable to past situations.

The existence of situations of corruption in Kenya requires reducing the company's transparency.[51] This alone already causes a significant cost, and thus generates problems.[52] This is a non-sustainable, readily imitated and an expensive advantage. It may therefore be neglecting its more lasting advantages.[53] Therefore, Corruption and corrupt actions are usually symptoms of a lack of management quality, conformity, and expedience. Furthermore, the advantages of corruption in Kenya are usually transient but the costs are usually permanent.

Corruption tends to become endogenous. It tends to grow, becomes organized and institutionalized. This change the rules of the game, hampers fair competition, generalizes the use of unsuitable practices, generates new situation of extortion and bribery, and causes decreasing returns to the same act of corruption.[54] In the end, it may attain extreme forms such as organized crime. As in the prisoner's dilemma, the conduct that may be financially profitable when the corrupt act is performed only once in a given environment[55] ceases to be so when the fame is repeated and when the environment adapts to new corrupt situations. This means that once corruption takes root it reaches a state of *equilibrium* that if far removed from the initial state. Above all, corruption generates individual learning processes, which change the economic conduct, and consequently the expected results from such conduct. Moreover, the range of moral and human problems that this learning generates within the company is very extensive. The managers or employees who are forced to take part have been affronted and those who take part in it willingly feel strengthened in this deterioration of ethical values. The atmosphere of trust starts to deteriorate. In an adverse selection process, the best people will probably leave the company. Others will express their discontent through absenteeism, low performance, and lack of initiative.

To summarize, corruption generates rejection and extension of process that disrupt the company's unity and therefore its capacity to operate efficiently and profitably.[56] Corrupt Acts performed by managers or employees are particularly serious, whether they seek to benefit the company or solely for the manages or employees benefit. This is because they indicate a lack of governance and control in the organization. To pretend that only the manager or employees concerned are to blame, and not the company or senior management is a mistake. This is because the company is responsible for the actions performed by those who work for and represent it. Another reason is that the image that these people convey to the public as well as the corrupt actions of employees and managers are often the consequences of the organization's goals, incentives and culture. It is often the case that employees who perform corrupt acts for the company expect the company to protect them. However, it is unlikely that an organization that permits or does not effectively prohibit this type of conduct will later have the courage to defend the employee who practices it.[57] The company and in particular its senior management has the duty first to effectively prohibit the practice of corruption within the company, even if it is to the company's benefit. Secondly, they have to prevent incentives from being created that encourages its employees to perform corrupt acts and thirdly to protect them from the pressures to perform corrupts acts in their employment. Likewise, employees and managers must feel responsible for eradicating situations of corruption within the company.

2.4.0 TAX EVASION-A Case Study of the USA.

Greatly increased product and factor mobility supported by the communications revolution have accelerated the growth of tax avoidance and evasion. This if unchecked could seriously threaten the fiscal power of the state. The combination of market liberalization and technological change that underpin so much of economic globalization has generated forces that, if unchecked could one day undermine the ability of a state to tax and spend as their citizens choose. The United States stands almost alone in insisting that the labor earnings of its citizens be subject to US taxation no matter where such earnings arise. Most sates simply forego such taxation completely. In sharp contrast, nearly all states claim fiscal authority over the personal capital earnings of their citizens. They however differ over how the overseas earnings of their corporations are treated. Some exempt such gains completely. Others including the United States give credit for foreign taxes paid and allow any remaining tax liability to be indefinitely postponed so long as the earnings are not repatriated. Switching corporate funds from one foreign state to another is a prime function of the jurisdiction known as *tax havens.* Another is the provision of global investment opportunity for individuals beyond the purview of their home tax authorities. *Tax havens* both rich and poor are typically defined by two characteristics. These are low tax rates at least for foreigner and transacting secrecy.

2.4.1 A Sketch of the Problem.

Tax havens serve many antisocial purposes in the world economy thereby switching stations from one foreign state to another for corporate profits. These are shut from higher tax jurisdictions through the manipulation of prices, book keeping, money laundering for dealers and terrorists. They are also safe depositories for third world *kleptocrats.* That is only part of the story since much information is concealed from the public.

A large share of deposits in the tax havens comes from upper middle class residents of Europe and North America who simply want to evade paying tax. Some estimates of the financial analysis held in the dozens of havens ran as high as five trillion dollars. This is about one sixth of estimated Gross World Product. Of this amount, three trillion may be held in bank accounts.[58]

Tax havens are widely used to avoid corporate tax obligations and the high income countries continue to reform their rules to reduce abuse. However, even if the corporate taxes drop sharply[59] or ceases to exist at all, a drastic reduction of the havens would

remain essential for the integrity of the system where it ultimately matters most. The level of the individual taxpayer[60] in the tax havens challenges the redistributive potential of personal taxation. In all countries, the effective taxation of income drops sharply when it is not withheld or directly reported to the government. The Inland Revenue service (IRS) estimates that income tax compliance varies from 97% on wages to 11% for the self-employed. The Treasury Department estimates that haven-based tax evasion cost the US US$70 billion in the year 2000. This is an equivalent of about 3.4% of Federal Government receipts. In Kenya, there are no official statistics on how much Kenya Revenue Authority is losing but it is losing but it is evident that most corporate entities evade paying taxes.

2.4.1 US Policy towards Havens.

Tax haven have historically not featured as an important political issue in the US although they have attracted much recent attention from their use by drug smugglers, international terrorist, and the ENRON saga. Tax havens also received a great deal of negative presses in early 2002 from a spate of corporate evasions of corporate income tax liability by shifting their headquarters to a tax haven.[61] Much of the evasion problem can be solved unilaterally by greatest US attention on how films claim national identity. Despite the tax havens' rather low profile until recently, The Treasury Department under both political parties[62] has attempted for many years to limit corporate tax avoidance by the manipulation of rules of tax haven use. In the early eighties however, the United States inadvertently accelerated the use of tax haven for evasion by individuals all around the world. This was by abandoning the collection of nearly all withholdings taxes on foreign investments made in the US thus increasing their effective yield. Nearly all the rich countries fail to withhold tax from most financial investments. If the individuals and institutions can hide foreign earnings from their home governments and if those earnings are not taxed elsewhere, there is maximum incentive to use the haven' intermediaries, who levy little or no tax themselves.

The change in Us policy came at a time when burgeoning Federal budget dictated a concern for borrowing costs, but its legacy remains. The increasing of supply funds into any single borrowing market means that a unilateral introduction of taxation would deny the levying state revenue. This is by raising local borrowing costs and putting borrowers at a competitive disadvantage. Although the United States would probably bear less of the tax burden than other world borrowers, unilateral change looks unattractive .[63] International politics finally gathered momentum after years of unilateral action against corporate and some individual abuse of the tax havens. This was particularly by the United States potentially effective collective action in the late nineties

The OECD[64] strongly supported by the Group 7[65], the US Treasury and the European Union, proposed to eliminate harmful tax competition in 1998 among the rich countries.[66]

Most attention has been directed at Belgium Switzerland, Luxembourg and Ireland. It was envisioned that these countries would either be successfully pressured from within the European tax of individual or corporate income tax rates but rather the use of different and lower rates for foreigners or investment rules that invited tax cheating.

The OECD also declared a willingness to introduce rotationally crippling sanctions against offenders outside Europe. These tax havens are sustained from two sources.

These are:

1) Low value added tax, which is essentially a sham, activity that allows corporations to avoid higher tax rates elsewhere by using tax haven addresses.
2) Secret financial mediation for foreign funds provided by business and well-off individuals worldwide whose motivation is largely tax evasion.

The latter practice is similar to much of what Switzerland has done for decades. Funds are often simply channeled globally into financial uses similar to those made if the tax evader has elected less circulators investment. Nevertheless, the investor escapes ta at the home country's expense. The Clinton administrations' strong support for the ORCD initiative faded quickly with the new administration. Treasury Secretary O'Neil expressed concern that the US was interfering with the tax prerogatives of other states particularly many that were small and weak. Much of the secretary's concern has echoed the message being forcefully. Presented TO the Congress.[68]

The libertarian argument that the OECD's work is cartel building by *undemocratic governments* collapses under the slightest scouting. Nevertheless, several elements of the OECD's demands on the tax havens were modified or removed. This is perhaps only because of the keenly watched Congressional deliberations following the September 11th attacks. This greatly reduced to zero tolerance for opaque international financial transactions. The administration stopped short of essentially scuttling US co-operation with other countries. The OEC's most important demand to the low-income havens requires sharing of information with tax authorizes of the ORCD countries relevant to the enforcement of those states' civil and criminal law. This trust has survived. Each haven was to have a plan for corporation in place for corporation in place. OECD member countries might take action against tax havens beginning 2005. Thirty –one havens produced a satisfactory response but seven did not.[69] Credible threats of OECD retaliation turned to reality that funds could only be profitably routed through the havens in the rich states.[70] A coordinated denial would avoid differential advantages to borrowers of haven dependent firms from states that are slow to retaliate.[71]

Three arguments stand out. First, the OECD is accused of treating its won with kid gloves about simply being dictated to, rather than genuinely consulted. Although the OECD did set up an elaborate consultation mechanism, this dialogue has scarcely been a discussion among equals. Finally, the havens have tries to make a substantive case that an attack on their practices affronts their sovereign right to have a substantive case that an attack on their own choosing. In all these areas, the tax havens could count on the libertarian US voices and the UN has expressed sympathy on the second issue.

The OEDC countries do not deny the right of other states to their own tax and financial systems. However, they do insist on regulating their own individual and corporate citizen's use of those systems. Unfortunately, for the tax havens, the substantive UN position is highly unfavorable to their very existence. The UN

latches on to procedural arguments as a pretext for a role of its own that would assist in abolishing international tax evasion in return for a formula assessment of Global Corporate Income Tax Revenues.

2.4.3The Kenyan Position

In Kenya, the regime of corporate tax evasion is not at an advanced stage though it can be said that it is not at infant stage. Foreign corporate entitles simply do not pay tax. Even if they do, it is minimal. Corporate entitles especially in the late in subsequent financial years. The effect of this is that they pay minimal tax or none at all. Some of them have foreign headquarter addresses. This makes it very difficult for the taxman to catch up with returns. Tax evasion is rife among Asian companies. One writer has argued that the Asians have perfected the art of bribery and corruption in the corporate sector that the sector is synonymous to them.

2.4.4 The current and future US role.

If the OECD countries stick to their guns they can certainly achieve greatly increased co-operation from the tax havens. Nevertheless, that may not be enough. A willingness to provide available information upon specific request contrasts sharply with the kind of cooperation currently being discussed between US and Europe. This provision provides for automatic intergovernmental sharing of earning information on some classes of foreign investment. Comprehensive and accurate identification of beneficiaries revolves around the very notions of deterrence of many tax havens. Effective OECD policies simply that investors there may one day dace compulsory withholding tax levies on ultimate borrowers in the rich countries. Amounts of withheld taxes would be refunded to the

Taxpayer only when documentation was provided and that the home country had been informed of the earnings.[72]

2.4.5 Conclusion.

The frauds that are prevalent in Kenya are corruption, tax evasion, insurance frauds.

These affect the common man more adversely hence the need to understand them and come up with mechanisms to control them.

Having discussed corporate frauds both historically and in their contemporary forms we now turn to chapter there. In this chapter, we will attempt to account for the existence of corporate fraud.

CHAPTER 3

CORPORATE FRAUD-A Theoretical Explanation.

In the previous chapter, we talked of specific corporate frauds in their contemporary and historical forms. We also undertook a case study of the US in the area of insurance fraud and tax evasion. We now embark in an attempt to account for corporate fraud. We will posit various theories and factors that make corporate fraud prevail. To this end, we try to explain the preference of fraud in corporations.

3.1.0 Preliminary

Fifty years ago, Edwin Sutherland observed that standard criminological theories were inadequate to account for corporate crimes and fraud. Most such approaches sought to compare criminals with non-criminals and to discover in the former some sort of biological, psychological or social pathology to account for their offending.[1] Sutherland said that you could suggest only in a jocular sense that:

> "The crimes of Ford Motor Company are due to the Oedipus complex those of the Aluminum Company of America due to an *inferiority complex,* or those of the US Steel Company due to *frustration or aggression,* or those of Du Pont due to *traumatic experience* or those of Montgomery Ward to regression to infancy."[2]

One question, which presents itself at the outset of investigating organizational pathology in Kenya, is how organizations can be seen as distinct from the people who form and run them. it can be argued that organizations *per se* neither think noract.[3] Such a contention, however, misses the important point that organizations are more than just the aggregate of individuals who constitute them.[4] The irrelevance of particular individuals in the structure and functions of business needs to be stressed, especially given the tendencies towards individualized forms of explanation within contemporary societies. In management training programs in many firms, there is a game commonly used as part of the program called the "*in-basket game'.* Management trainees are asked to imagine that they unexpectedly replaced the previous manager over the weekend and are confronted with the unanswered mail in their predecessor's in-basket. The challenge is to respond appropriately to each letter. The aim of the exercise is to be able to make the transition between one manager and another unnoticeable as well as to make the manager a person irrelevant in the functioning of the corporation.[5] Rather the organization itself is the acting unit, which can overwhelm personal standards of ethical conduct. It is no longer of corporations. Rather it is the policies a structure of the institutional setting within which they work and live.[6]

It may well be that Kenyan organizational offending is boosted by key personnel in any given company being occupationally obliged to periodically mix with their counterparts from other organisations.[7]

3.1.1 The Human Nature Theory.

Hirschi and Gottfredson have also ventured to put a general theory of crime, which accounts for the frequency and distribution of corporate crimes and fraud. They contend that as with ordinary common crime, the corporate offender seeks personal benefits, and that the social setting is not relevant to the cause of crime. The usefulness of a category of corporate crime is also dismissed as irrelevant.[8]

In their view, the concept of human nature that best organizes the data is that found in the classical assumption that human behavior is motivated by the self-interested pursuit of pleasure and the avoidance of misfortunes. Corporate crimes in Kenya are events in which force or frauds are used to satisfy self-interest.[9] Force and fraud can produce results rapidly and help to enhance certain events and ensure that a minimum effort is used.

Kenyan Corporations exercise enormous influence over social affairs and it is much more important to understand corporate fraud. While one cannot reduce criminal phenomena to actions, the later question of how good corporations come to do bad things is nevertheless a relevant one. Techniques of neutralization can be seen in operation in many areas of organizational crime. Such techniques of offer an insight into the motivation of corporations if we understand corporations within a structural framework of enablement and constrint.[10] Reference to techniques does help in understanding how the wrong can be sustained and repeated by corporations, which are neither insensitive nor amoral in other ways.[11]

Gioa has explained how serious executives in a corporation can come to have their own ethical standards and inclinations overcome by the organizational demands of their work.[12] This phenomenon is comparable to the concept of a "*subculture of delinquency"* used by Marza. Thus, those subcultures respectively enable Kenyan corporate officials and other management personnel to commit crimes without too many pangs of conscience. Through their sanitizing prism, each subculture softens criminal acts so that they assume the appearance of not being against the law or it transforms them into acts required by a morality higher than that enshrined in a parochial criminal law. From this theory it can be argued that the frauds in Kenyan corporations arise due to human nature. Many Kenyan executives engage in fraud due to pressure from society. They are expected to lead a life different from that of the ordinary Kenyan.

3.1.2 Sub-culture Theory.

There are many subtle progressions of reasoning in Braithwaite's argument, but before we address this, it is important to highlight his central idea. He argues that the distribution of organizational fraud in society depends on the availability of legitimate and illegitimate opportunities to achieve organizational or departmental goals. The extent to which hostile industrial policing of organizations causes them to become recalcitrant and foster "*subcultures of resistance to law"* and the extent to which organizations without resistant subculture exercise informal controls which expose offenders to shaming. The Kenyan Companies Act has numerous loopholes that facilitate fraud.

In this analysis, control theory works only where there are more definitions favorable to non-compliance. Sub-cultural and control theory accounts are posited as having differential explanatory power, depending on where an organization is along the "differential association continuum'[13]. However, if its opportunities for legitimate gain are blocked then the corporation will be re likely to offend. The situation will worsen if the state authorities respond to its offending not with a policy of 're-integrative shaming' but with such an uncompromising shaming that the corporation is completely alienated. The provisions of the Kenyan Companies Act adequate to prevent commission of fraud by directors.

Using opportunity theory[14], it can be argued that Kenyan organizational crime is more likely to occur when an organization suffers major blockades of legitimate opportunities to achieve its goals and where it has the opportunity to commit crime.[15]

Where Kenyan companies are faced with blocked legitimate opportunities they may develop a subculture of law breaking. Gioa's study[16] of price fixing in the heavy electrical equipment industry is a good illustration of the way new executives in a company were socialized into the business of illegally conspiring with competitors to fix consumer prices. The challenge or a theory of organizational crime is to give greater specificity of content to the social conditions in which the stake in compliance will dominate the social conditions, which tip the balance to a stake in non-compliance. Kenyan corporations commit fraud because they want to maximize their profit. This culture of profit acquisition makes them do anything to achieve this end. In the end they resort to fraud.

3.1.3 Labelling Theory

Subcultures of resistance develop in an organization when they are stigmatized by the authorities. When originations are treated as irredeemably crooked, they are more likely to become crooked.[17] Nelken [18] has noted that the labelling approach has been comparatively neglected in the study of corporate crime even though it could be seen as particularly relevant given the relevant recent laws regulating business. The sharp swings between political projects of regulation and deregulations in Kenya and the divergent views of different political groups as to the appropriateness of criminalization are also another fact. Nelken's work[19] is one of the very few works to have examined the processes of labeling and delabelling in relation to business misconduct.[20] Those who adopt an interpretative perspective are obliged to concede that the negotiation of meaning is biased in favor of structurally powerful groups. Nelken argues that such an approach[21] allows us to identify what he refers to as coherence *without conspiracy*.[22] In our case we can label Kenyan corporations as inherently fraudulent. Labelling theory is not a viable option to explain why Kenyan corporations engage in fraud. Rather it is a combinations of various factors that lead to fraud.

In most Kenyan organization definitions favorable to compliance with the law hold sway even though it would often be more rational economically to break the law. Here control theory will help us understand the problem. We should never underestimate the moralizing social factors within complex corporations. The tighter the managerial control over work practices, the less likely, there is to be organizational crime.[23] There is no doubt that Kenyan corporate crime needs to be partially understood with respect to the organizational characteristics of different corporations. A full-blown theory of Kenyan corporate fraud needs to take account of various aspects of organization form and structure.[24]

3.1.4The Social Organization Theory

One of the essential reasons for examining Kenyan organizations is that their structural and cultural features can greatly affect the distribution an availability of opportunities for illegality within an organization.[25] Senior Kenyan personnel and high status officers are generally bestowed with more trust than others are in greater losses than when people of the lower end of an organization's hierarchy offend in the course of their employment to achieve organizational goals.[26] In Kenya, the social structure of the corporations enables executives to commit fraud. The executives are the ones who sign most documents of the company. This in itself can facilitate fraud because there is no mechanism to check transactions entered into by the executive save at the time of auditing. This social structure enables Kenyan corporations to commit fraud.

It can further be argued that the nature of the roles people play in an organization or company are more important to appreciate for an understanding of occupational offending than their personal characteristics or social status. It is time to integrate corporate fraudsters into the mainstream organizations by looking beyond the perpetrators wardrobe and social characteristics. This can be by exploring the *modus* operandi of their misdeeds and the ways in which they establish and exploit trust.

The thrust of this theory is that in modern capitalism there is in commerce and industry an almost universal use of the '*principal-agent'* relationship. Businesses and business people have to engage the service of all sorts of experts to perform them. These people as agents have to have a certain amount of trust and freedom to exercise a professional discretion over what they are doing. They have good opportunities to misuse their powers. All principals can do to protect their interests is to select their agents with care.

They can then try to build into the agreement alignments between the interests of principal and agent like fees and profit-sharing plans. Worse than simple agency agreements are the fiduciary relationships which proliferate in business. Whereas agency agreements are relatively summetric,[28] in a fiduciary relationship one party is at the mercy of the others discretion. The agents can therefore shape the nature of the relationship and this will often result in one which is conducive to fraud. Punch has observed that, it is difficult to understand why some corporations under certain circumstances choose to adopt deviant solutions to solve business problems because analysis has to touch on performance.[29] Each case, for instance, can be rich in context, if not unique, and can appear to defy comparison.[30]

3.2.0 CORPORATION AND POLITICAL ECONOMY

3.2.1 Anomie and Corporate Fraud.

In the use of the anomie concept it can be noted that the culture of any society defines particular goals, which it elevates as worth striving. In the American society, the acquisition of wealth has always been seen, by conventional thought, as a noble and virtuous pursuit. The same is also true of the Kenyan society. Wealth is seen in many quarters as emblematic of personal worth.[31] In modern society, the goal of acquiring wealth has been given great emphasis. Those who acquire wealth illegally are often represented as enjoying a much better life than those who slog away in a complaining manner.[32] *Anomie* is the contradiction between shut off any such realistic possibility for many corporations. Under such pressures, Kenyan corporations take one of the five options, depending upon how they regarded the cultural goals and the institutionalized means of achieving them namely:

1. *Conformity*
2. *Immolation,*
3. *Ritualism*
4. *Retreatism, and*
5. *Rebellion.*

In what has been termed 'stable societies', it can be argued that most Kenyan corporations opt for conformity where they accept the cultural goals and the institutionalized means of achieving them. Most frauds in society however take the form of innovation. Here corporation remain faithful to the cultural goal of acquiring wealth but they find that they cannot succeed by institutionalized means. They then resort to use illegitimate methods to acquire wealth. Kenyan businessmen may devise different forms of corporate mechanisms entailing fraud and misrepresentation, or they may cheat on their income tax.

Anomie provides some insight into the offending of business-people and Box argues that such a scheme can also be applied to corporations. The argument of Box takes the profit maximization as defining characteristics of the corporation. This makes the corporation inherently fraudulent.[33] Consequently, executives investigate alternative means[34] and pursue them if they are superior to other strictly legitimate alternatives.[35]

In a novel development, Box argues that in seeking to pre-empt or mitigate the uncertainty introduced in their operating environments[36] corporate motivation to illegality must of course be translated into reality and mediated by real men and women who face differential opportunities.[37] The simple formula of Box is nevertheless a helpful one. Certainly, we know that the many markets are awash with hundreds or thousands of companies competing with each other continuously. One corporation's competitive advantage is relative failure for many other companies, and thus for the human beings who depend on them as a source of income.[38]

In this context, it is important to bear in mind that there are no quantitative limits set on profit maximization.[39] the structure of contemporary societies is inherently conductive to anomie trends.[40] Structural pressures and strains may be applied both to those at the top as well as their subordinates. The employment of deviant methods may be the only possible way of dealing with problematic situations. Deviant behavior may be further promoted and maintained by corporate policies. This is by processes of interaction leading to widespread rationalizations, which excuse and justify illegal practices. This is also true of the Kenyan society. Anomie trends may then ensue, as the use of profitable and effective but illegal techniques become widespread. They then convey the impression that in order to be successful, business cannot always be entirely compliant with the law. Given the existence and legitimization of such practices, more of them can occur even in the absence of compelling pressure.[41] Kenyan companies often end up committing fraud or making terrible reckless mistakes because they are desperately endeavoring to acquire, retain or regain a significant slice of the market.[42] Anomie trends could be disrupted and minimized through mechanisms of social control. It can be suggested that Kenyan corporate deviance, which is seen, as a product of existing cultural, structural and economic demands, is at least as serious a problem as ordinary *predatory street crime.* This is because that it has significant implications for the social order. However, anomie is not a good theory to explain Kenyan corporate fraud.

3.2.2 Capitalism and Social Structure

Merton[42 has] described as a '*Copernican Revolution'* the change in the sociology of knowledge that came when scientists began to look for explanations not only of 'mistakes' but also of the truth'. These are explanations of what id socially held to be true, plausible or valid knowledge. Aubert had noted[44] that there are some obvious reasons why the origin and function of deviant behavior have been the focus of scientific attention. Rather than just gaze at those entities, which offend [46], it might be quite illuminating to focus on the general running of other companies to look at what pressures they are experiencing. We can look at how close their conduct comes to violating law and if we can conclude anything from why we think or know that, they are not offending.

The economic and social structures as well as political environments surrounding companies can become useful as a source of knowledge about corporate frauds as understanding corporations *per se.* It can be observed that 'what is theoretically important is that Kenyan corporate fraud seems to be one of those phenomena which are particularly sensitive to and therefore highly symptomatic of more pervasive and general feature of the social structure.

Crucial elements of that social structure for corporations in Kenya include the nature of the markets in which they operate and do business as well the dominant ideologies within any social order in which they function. It also includes the nature of regulation and enforcement to which they are subject. Account must be taken of each of these macro- level phenomena in attempts to explain corporate fraud in Kenya. Without this it might be difficult to understand corporate fraud in Kenya.

3.2.3 Markets and industry structure.

It is possible to argue that Kenyan corporations are criminogenic and fraudulent in various ways. It is important to emphasize that not all such arguments derive from *left-of-center*

Or critical research from which one might expect a general antipathy to free market. For example, the classic study of criminogenic market forces conducted by Leonard and Weber in 1977 found out that there should be a general commitment to free market principle. They argue that when the markets are allowed to develop in a particular way crime are' coerced' by such structures to thrive. Their study focused on car manufacturers in the USA, which is one of the most solidly entrenched oligopolies among the United States industries. The gist of their contention is that because only three gigantic corproations[47] are responsible for virtually all vehicle production in the USA, they are able to dictate very unfavorable terms to individuals or companies who seek car dealerships. The result of this is that car dealers come under immense pressure to commit various frauds like cheating customers on serving and making false statements when selling second-hand cars. Leonard and Weber cite many examples of the illegal and unethical conduct that abound in the industry. In order to sell the number of new cars required of them by the manufacturer, the dealers have to drop their prices to such low margins that they could not survive without engaging in unlawful practices in order to make money.

What appears to the public to be unethical or criminal and fraudulent behavior on the part of the dealers represents 'conditional' crime stimulated by conditions over which the dealers and mechanics have little control. Perhaps a better phrase would be 'coerced' crime since it results from the coercion of strong corporations whose officers can utilize the concentrated market power of their companies to influence dealers and mechanics to serve company objectives.[48]

Kenyan corporate policy can thus produce extensive low-level offending. *The big three* motor companies offer the mechanics in the dealerships a 'flat *rate'* standard set for repair jobs. There are also persuasive and completely contrary fraud and crime. There is great evidence that Kenyan corporate fraud increases when industries are deregulated. The relationship between markets and corporate crime remains indeterminate.[49] These sensitives us to the need to examine market structure as one factor conducive for criminal activity on the part of corporations.[50] Attention should therefore be focused upon 'crime facilitative' systems. In this latter model of a criminogenic system, members are not circumstantially forced to break the law. They are presented with extremely tempting structural conditions, high incentives and opportunities couple with how risks that encourage and facilitate fraud.

Crime facilitative systems by comparison, work based on temptation and incentives. Estimates of the level of loss from securities theft and fraud in the USA were as high as US$ 50 million at the time they addressed the issue.[51] Fraudulent dealings in securities take at least two forms. The first is the *'conversion'* of stolen or counterfeit stocks or bonds into negotiable instruments that will be accepted and traded by banks. The second form of fraud in-

volves the creation of fake securities from scratch basing their value on fictional companies. From a detailed study of the Senate hearings on the securities industry, the extract three structural features of the securities industry that work to facilitate fraud. These are the pattern of legal liability, the industry's traditions of commerce, and the incentives for market flow.

The first factor that causes fraud in the securities industry is the way business is carried on according to the legal framework. Banks and brokerage firms take advantage of a privileged legal status known as holder in due course. This gives them a clear legal title to any securities they have purchased in good faith even if these were stolen. Consequently, unless the seller indicates to the purchasing bank that the securities are stolen, the bank is safe in buying almost anything. The banker is under no obligation to check the validity of anything he or she buys. The second crime facilitative factor is the tradition of commerce in the securities business. The authors cite as example, the use of trust in modern banking. Bankers relate to large depositors as important men and women and treat them with care lest they lose them.

> 'Apparently the idea of subjecting large depositors to close questioning and checking, on the chance that they might be crooked, strikes many bankers not only as poor business etiquette bur also as impolite. Without some compelling reason, it would be an improper way of doing business. Bank secrecy laws, particularly on the international level, are built on this tradition of trust, protecting the privacy of depositors presumed to be important and honorable. This feature of the industry, of course, makes it possible for conmen to take advantage of the banker.[52]

3.2.4 The Profit Motive and the Commoditization of Social Relationships

Beyond the consideration of market and industry forma, and even more fundamental and less tangible issue of potential explanatory significance *vis-a-vis* corporate fraud is that of the structural necessities of contemporary capitalism. The first of this is the demand for profit maximization. The paramount economic priority of Kenyan companies is to be profitable. To this end, business is predominantly based upon the making of amoral calculations.

3.2.5 The Regulatory Structure and the Production of Fraud.

It is important to address regulation in the context of understanding the causes of corporate fraud. We must accept that Kenyan corporations are inherently criminogenic and fraudulently engage in illegalities at particular points. In addition, Coleman noted that a knowledge of the pattern of the state's enforcement efforts and the likelihood and severity of the punishment for different offences is important to our understanding of the attractiveness of various opportunities for fraud.[53]

One route into the terrain that needs to be covered if any understanding between regulation and corporate fraud is to be reached is set out by Kramer. He says,

> '*We need to develop an understanding of the political economy of corporate fraud. We need to know how and why a corporate capitalist economy systematically generates such fraud, and why the state is so important in its attempt to control these acts. We need to understand how a corporation's organization, goals and structures relate to fraud.'*[54]

The amoral nature of the operation of commerce in Kenya is a sine qua non of capitalism.

There is evidence to suggest that another factor lending support to regulation[55] was that it assisted in the discipline and regulation of Kenyan corporations.

3.2.6 Competition and Its Evils.

The economic structure of a society may also be conducive to corporate fraud. Generally, countries following the free enterprise system[56] stress competition in the market. Extreme competitiveness, in turn produces pressures of success that often encourage the rationalization of illegal short cuts. This is the case when Kenyan corporations are scrutinized.

What Richard Quiney has said in relation to the American economy is also true for Kenya. He says that the economy of American society not only creates and perpetuates criminal activity in business and corporate enterprise, but foster a kind of crime organized for the explicit purpose of making economic gain by criminal activities.

John E. Conklin has enumerated a number of ways in which the economic system encourages s business crimes. These include the nature of marked conditions, the drive for profits, the emphasis on consumption, and permissiveness of the trust relationship in commerce as well as the structure of large corporations. Many corporate frauds in Kenya are the product of market structure.[57] Effecting change in the market structure of an industry by government regulations may be conductive to bribery, kickbacks, and pay offers.[58]

The quest for profits may also lead to corporate frauds. Profitability is regarded as the primary, if not exclusive goal of a business enterprise. When profits are unstable, unsuccessful businessmen may turn to fraud to shove up their position.[59] Moreover, the drive for profits may be an important determinant of illegal behavior even in prosperous times. Too much emphasis on consumption also acts as a catalyst for frauds. Kenyan businessmen not only produce goods and services but also create new demands and exploit existing markets. This they sometimes do by means of fake advertisements, misrepresentation, or other deceptive trade practices. Intense competition in an industry may lead to businessmen to engage in bribery or false advertising, so as to get a competitive advantage in the market place. The emphasis on consumption[60 fosters] fraud such as embezzlement, as well as being productive of traditional property offenses.

Trust is necessary for the smooth functioning of the commercial world, but it increases opportunities for the violation of fiduciary trusts.[61] One trust relationship, which is essential to the economy, is credit. This is based on the creditors' faith in the repayment of the debt by the borrower.[62]The emergence of large corporations provides opportunities to commit fraud in several ways.[63] In large Corporations, responsibility is generally spread over a maze of departments and divisions. This makes it difficult to pin point exactly that person who encourage executives and employees to commit fraud. Poor communication among Kenyan corporate

departments and lack of effective supervision may also be conducive to the violation of law.[64]

3.2.7 Leniency.

Although the costs of corporate frauds in Kenya are persuasive and exorbitant, it generally receives lenient treatment from the criminal justice system. This is because legislatures are usually assigned the crucial role of enacting laws prohibiting certain kinds of behavior. Businessmen in Kenya generally have powerful pressure lobby groups within and outside parliament, to protect their interests. They tend to block as a matter of priority enactment of laws that adversely affect their interests. They may even exercise their influence to effect the passage of weak laws providing ineffective sanctions and enforcement agencies in Kenya, for their part are generally reluctant to prosecute corporate offenders. Moreover, even in cases where prosecution is launched, the courts are too lenient towards them. Harsh sentences are rarely imposed on these criminals. The reasons for such lenient treatment are manifold. Criminal justice systems nearly everywhere are currently overwhelmed and pre-occupied by the problem of street crimes. They seem strangely too small, too clumsy and too fragile to deal effectively with corporate crime. In short, in cases of corporate fraud in Kenya, prosecution is uncommon; conviction is rare and harsh sentence almost non-existent. In addition, as we have tried apathy only fertilize the ground in which this pernicious of crimes breed. This is especially the case where in Kenya corporate executives engage in fraud and nothing is done to remedy the situation. Many Kenyan corporations especially banks and insurance companies simply wind up and disappear into thin air.

3.2.8 Long Term Business Risks.

First, there has to be recognition that regardless of the legal and moral niceties[65] corruption in Kenya represents a significant business risk. So in the face of these dangers, why do business people and corporations pay bribes at all? Sometimes they argue that bribe is part of local custom. They may also beleive[66] that there is no choice in the face of what amounts to be a form of official extortion. Competition is another vital factor. Executives in Kenya often claim that as much as they dislike the practice, they have to arrange kickbacks to secure business otherwise, some unscrupulous competitors will win contracts in their place.

3.2.9 Conclusion.

Corporate frauds in Kenya are caused by a combination of various factors. The following are the major contributors of corporate fraud.

- The sub-culture of the Kenyan society.
- Structural organization prevailing in the Kenyan corporate sector
- The capitalistic tendencies of the Kenyan Corporations.
- The market and industry structure in Kenya
- The profit motive and the commodization of Kenya corporate relations.
- The inefficient regulatory structure in Kenyan corporations
- Leniency in enforcement of Kenyan corporate laws.

When all these factors are acted upon by corporate entities they tend to generate fraud. Having exhaustively explained corporate offending we now turn to chapter four where we look at the way in which the state regulates and punished corporations.

CHAPTER 4

4.0.0 PUNISHING AND REGULATING CORPORATIONS

Preliminary

As we have noted in an aside in a previous chapter, it is certainly the case that many of the arguments regarding the globalization of economic activities are greatly exaggerated. Moreover, as globalization of capitalism is hardly new there is need to regulate corporate activities. In this chapter we examine ways in which corporations can be controlled.

4.1.0 Regulating Corporations

Numerous studies document the extent to which a compliance-oriented approach to the enforcement of regulation is the predominant one amongst regulatory bodies. The goal of a 'compliance strategy' on the other hand is to prevent harm rather than punish an evil aiming for social repair and maintenance at minimum cost. Enforcers respond to problems negotiating future conformity standards, which are administratively determined.[67] This allows the development of social relationships between rule-enforcer and rule-breaker.

Overall, what prompts a sanctioning rather that a compliance response is not who does the law enforcement so much as the sort of behavior, which is subject to control. A compliance-oriented approach is essentially one of persuasion and bargaining.

4.1.1 Corporate Crimes and real frauds

The compliance school also argues that there are unique features pertaining to corporate illegalities that distinguish them from the so-called traditional frauds.[68] First, the offenders are different. The business enterprises [69] that regulatory inspectors deal with live in a strange and anarchic world. A second set of arguments advanced to justify non-punitive modes of regulatory enforcement center around the applicability of *mens rea.* In many cases of regulatory violation, an interest injustice in the use of a standard of strict liability, and a claim that most regulatory offences involves acts or commissions, which are male prohibita rather than mala in se[70.]

Third to these arguments is also often added the practical caveat that problems of establishing guilty intent or liability are compounded in the case of regulatory deviance since such deviance occurs within an organizational framework.[71] Such arguments are predictably reinforced by the fact that many regulators and the judiciary in practice displace standards of strict liability utilizing common sense standards of moral culpability in their place.

The distinction between what is *mala* prohibita and *mala in se* are in many respects subject to change .[72] they are often based on a curious inversion of intention and are indifferent of any moral hierarchy.[73] It is possible in law and in its enforcement to clarify legal responsibility in and around corporations.[74]

4.1.2 Strict Enforcement as counterproductive.

Some authors have argued that corporations are not evil calculators. They argue that their offences are increasingly distinct from real crimes. They also argue that to adopt enforcement strategy based upon strict enforcement [75] will be more than simply ineffective. Rather it is likely to produce quite the opposite response to what is intended.[76]

The first objection is that such enforcement strategy engenders rigidity and legalism.[77] This is a claim, which found political audience, but is empirically and conceptually sloppy. The second objection posted by Kagan and Scholzt is the tendency of such an enforcement strategy towards the stimulation of opposition and the destruction of co-operation.[78] Firms regulated strictly might in fact organize politically and attack the agency at the legislative level.[79] It is interesting that at this point there is recognition not simply of inequalities of power but of power operating at a micro and indeed, political level.[80] In general the absurd argument is that enforcement is always entirely contingent upon the acquiescence of the regulated.

Moreover, it is clear that in some particular set of political and economic circumstances, enforcement strategies stress consultation and conciliation. In the end they end up with agencies enduring the industries own evolution of what is reasonable and allow companies to negotiated their way out of penalties for violating the regulations. This is precisely why claims reflect the power of capital and not its inherent reasonableness. These aspects of compliance-oriented approach also raise a culture for corruption.

4.1.3 A case of enforced self-regulation.

There has been argument for enforced self-regulation. There are some similarities between this and the compliance school. First, the work of Braithwaite in the use of the notion of enforcement pyramids places compliance-oriented strategies as the first and predominant regulatory option. Second, both arguments for compliance oriented enforcement and enforced self –regulation make claims that corporations need to be understood as other than rational, amoral entities. Third, both sets of arguments have been labelled as co-operative models of regulatory enforcement. The essential element linking them here in the underestimation and failure to adequately explain corporate power.[82]

We know that it is unrealistic to expect that our generation will see the public resources devoted to corporate fraud control approach anywhere near those expended on crime in the streets.[83] In the absence of effective regulatory enforcement it is difficult to understand this phenomenon.[84] corporations should therefore devote resources to the understanding and control of such activity. It is worth noting that these arguments are very close to Mintzberg's claim that trust is necessary in attempts to *'control corporations*.[85]

We should note that as Braithwaite and Fisse define self-regulation as distinct from deregulation. The latter term is often used very loosely, but in the context of corporate fraud, deregulation refers to a removal of laws designed to regulate the corporation or perhaps the explicit withdrawal from the enforcement of existing laws.

The essential requirements of effective self-regulatory system combine structural features supported by aspects of an organizational culture. These in their combination produce a tendency towards compliance .[87] In general, companies must be concerned not to put employees under so much pressure to achieve the economic goals of an organization that they cut corners with the law. Currently the Kenyan legislature has not yet some up with a sound Companies Act. The present one was enacted in 1948 and most of its provisions are based on the parent English statute.

There is however, a sixth principle of effective self-regulation that underpins the other five, namely that companies and managers must have the motivation and willingness to self-regulate.[88]

We believe companies can be so motivated both from their internal deliberations as moral agents, more importantly from external pressures calculated to make effective self-regulation an attractive policy. Direct regulatory enforcement is one outstanding way of putting pressure on companies to self-regulating.[89]

Any proposal would need the approval of an external regulator, an approval that may entail a series of negotiations. Subsequently external regulators would oversee not compliance, but the functioning of a company's own in-

ternal compliance inspectoral functions.[90] Regulatory regimes should move towards goal-oriented rather than prescriptive legislation. To this end the Kenyan legislature should come up with a stratu8re compelling companies to self –regulate. This should be included in the Companies articles and memorandum of association prior to incorporation.

4.1.4 Deterrence and regulation.

It is certainly important to point out that an enforcement process can only effectively function where any sanctions that are formally at the disposal of regulators are credible ones. That is such sanctions are used in the face of non-compliance.

Thus a deterrent and potentially punitive regulatory strategy can be cost effective in that it gives the taker less thereby the regulators have to use them. This seems to be based upon the view that corporations do make explicit calculations regarding the costs and benefits of compliance and non-compliance. Most Kenyan corporations might not be able to effectively self-regulate since we are yet to enact comprehensive states.

For a variety of reasons, this ability of corporations to self-regulate is misplaced.[92] First we know that based on historical record regulations and regulatory agencies have been established because most of the corporations have simply not been self-regulating. Second, we know also that corporate executives can add do falsify records. Third the structures and mechanisms on of self-regulation can be highly cynical. Fourth, the removal of pressures upon middle managers and the ability of internal inspectors to act in ways are only possible under certain limited conditions for certain limited periods of time. Fifth and perhaps most problematic of all, is that self-regulations in a hostile economic and political climate is likely to be expropriated by dominant economic and political forces. [93] However corporate fraud offers a sphere in which deterrence is much more likely to be effective.

The discredited doctrine of fraud control by public disgrace, deterrence, incapacitation, and rehabilitation can be successfully applied to corporations. Thus, corporate fraudsters may be among the most deferrable types of offenders. Deterrence is fundamentally flawed both as a practical strategy, and indeed at a conceptual level. However, deterrence has a rather difference potential, which we present in relation to Mathieson's cogent rejection of the principle and practice of deterrence.[94] First, many corporate frauds tend not to be acts of commission, but are actually ongoing states or conditions.[95] Second the requirement for proactive inspection and regulatory strategies raises the issues of enforcement resources. Third, there is a further objection to the principle of general deterrence.

Fourth, in the context of corporate fraud, deterrent sentencing should not serve to exacerbate social inequality. Taken in corroboration, the above points indicate that deterrence as a principal enforcement activity for the sanctioning of corporate fraud has considerable potential.[96] In a sense, then deterrent law has the same characteristics that ascribe to law in general namely that it is facilitative and productive rather than constraining, and negative**.**

4.1.5 Regulating company secretaries.

General legal position of the company secretary

a) Secretary as a servant of the company

The secretary of a company is a servant of the company whose duty is to act in accordance with the instructions given by the directors. This puts the secretary in a very vulnerable position. The directors can use the secretary to facilitate fraud.

b) Secretary as agent of the company

The secretary has ostensible authority to enter into contract on behalf of the company. This in itself can lead to fraud. The secretary can enter false 'ghost' contracts and present vouchers to the relevant authorities. But this has to be in collusion with one or more of the directors.

c) Secretary as officer of the company

The board of directors appoints the subsequent company secretary. This is pursuant to regulation 110 of the Articles of Table A [97] or as the Articles of a company may provide.

The provisions of the Companies Act in relation of the position of the company secretary are inadequate for they can be maneuvered to facilitate the commission of fraud. This should be revised to reflect the current global trend whereby the company secretary is regulated by a company code of conduct, which the secretary should follow strictly to the letter.

4.1.6 Effectiveness of compliance enforcement.

Much of the work of the compliance school focuses upon the limitation of 'punitive' regulatory enforcement. Nevertheless, it must be said that what compliance theorists rarely do is to detail the extent to which a compliance strategy works. Their concern is more to highlight 'alternatives'' and notably punitive forms of enforcement are unworkable. Compliance oriented enforcement hardly seems to be successful. Indeed as the norm, by which corporations are regulated, the litany of fraud is hardly a ringing endorsement for compliance- oriented enforcement. [98] For us our clause on criminalization and effectiveness are incompatible, and criminal law is too slow and too expensive to regulate corporations. The reception accorded to such ideas must be understood in ideological terms.

No single Kenyan corporation has been prosecuted for violating the provisions of the Companies Act. Fraud is rife in Kenyan corporations and the Kenyan shareholder is annually defrauded without knowing. Thus the emergence of these discourses themselves need to be understood within the contexts of re-emergence of neo liberal agendas across the industrialized and industrializing economies, and an increase in the structural power of capitalism.

4.2.0 Punishing corporations.

One distinctive problem in the area of corporate fraud is the issue of how such non-human legal personalities

should be punished if they are convicted of fraud. This is not purely an ecological question. If the punishments that could be imposed upon organizational offenders are of questionable effectiveness, then it may seem pointless for prosecutions to be brought. This is because no punitive outcome can possibly flow from criminal proceedings against offenders.

4.2.1 Crimes against 'social regulation' and crime against 'economic regulation'

There is a significant difference between crimes against social regulation and crimes, which are against economic regulation. Into the latter category come offences like those against the Kenya Revenue Authority, or those against Customs and Exercise. The regulation of corporate fraud is an ever-changing process and at any given period, some corporate fraud will be against the interests of capitalism. The socio-economic system of modern capitalism is much more allergic to financial chaos or subversion than it is to the sacrifice for consumers and workers in the pursuit of profit. Suffice to say that the

plotters of the Goldenberg scam never contemplated public outcry. That is why most of
the files disappeared mysteriously when the inquiry started.

Following various commercial frauds in the 1980s in the UK, the serious fraud office was set up under the Criminal Justice Act 1987 to mount an effective and coordinated response to serious fraud. Its aim is to deter fraud and maintain confidence in the United Kingdom's financial system. The Kenyan government took a similar move in the late 1990s when it established the Kenya Anti- Corruption Authority, which was subsequently is to pursue the appropriate and prompt investigation and prosecution of trial. Corporate fraudsters in Kenya should be tried for economic crimes against the people of Kenya and the government are large.

In **R -vs- Kazni**[99] it was held that in times of economic stress the court
Should punish offences of commercial fraud with severe penalties to deter others. In another leading case of **R – VS- Barrack,**[100] the Court of Appeal of England issued some general guidelines about sentencing in cases of theft and breaches of trust by employers and professional persons. In effect, the court's view was that such cases were so serious that only a custodial sentence could usually be justified. That view has since been followed in most cases. The Serious Fraud Office handles cases of serious and complex fraud at any one time where the money at risk in each case is UK £1 million or more. The Kenyan legislature should take a leaf and enact proper laws to prosecute serious fraud.

The Metropolitan and City Police Fraud Department, formed in the UK in 1946, is responsible for investigation of large and complicated frauds involving limited companies and banks, and also more recently offences of public sector corruption. In Kenya the Anti-Corruption Police Squad Unit was formed to deal with similar matters after KACA was disbanded.

4.2.2. The current sanctions available against corporations.

4.2.2.1 The criminal courts.

Both Kenyan criminal law and English Criminal law have developed the fiction of corporate personality. A Corporation can only act through individual persons. If there is an individual who has committed the actual criminal conduct required for an offence[101] with the appropriate culpable frame of mind and who is sufficiently important in the corporate structure for his acts to be identified with the company itself, the company as well as the individual itself can be criminally liable unless the statutory provision creating the offence precludes this.[102]Under this principle a company can even be liable for a common law offence such as conspiracy to defraud where the mental element is central to liability, as in **R-vs- ICR Haulage Ltd** [103] where the agreement and intention of the managing director were regarded as those of the company. The only criminal penalty that can be imposed on a company in English law is a fine or a compensation order.[104] No Kenyan corporation has been successfully prosecuted for fraud despite the fact that many have engaged in fraud.

4.2.2.2 The civil courts

Very few cases actually ever reach the courts, the vast majority being settled out of court. In majority of cases, the Plaintiff's claim for special damages for actual financial losses incurred before trial or settlement is usually dismissed. There is a case pending at the High Court where a bank is being sued for breach of trust when the bank violated the Banking Act by using the client's money. Civil litigation is a long process and the Plaintiff has to wait for some time due to the number of cases pending at the High Court in Nairobi.

4.2.2.3 General issues of corporate punishment.

Companies are enormously powerful social actors. The issue that arises when there is a crime is what the most suitable sanction against the company is. Once an enterprise is set up legally as a corporation it follows that certain defined duties are imposed on some of its personnel and rights accrue to certain people involved with the new body. The preponderance of these legal rules facilitates commercial fraud.

Whether the criminal law and sentencing can now be successfully adapted to, control endemic commercial delinquency is an attempt to address this problem. Corporate actors are ubiquitous and extremely powerful elements in our social life yet the criminal law has not been properly adapted to meet this social development. Ken-

yan fraudsters simply wind up the corporation in question and form another. Most of them are politically well-connected individuals and punishing then is almost unheard of.

4.2.3 Corporate fines

There are many types of corporations and the reporting of sentencing in relation to most of these types is quite spasmodic and random. Fines are legally calculated to be used as a form of punishment.[106]

It may be that much more important than the juridical differences between personal and corporate liability is the certainty of prosecution flowing from commercial recklessness, coupled with a severe fine.[107] A factor arguably conducive to companies acting with greater prudence in relation to their strategic commercial policies is the high level of a wards recently evidenced here and within the jurisdiction of the American courts.[108]

4.2.4 Alternative sanctions to the fine

Nothing that a small fine on a corporation may have no impact and a large one might simply be passed on to shareholders or consumers causing injustice. Punch [109] suggests the alternatives used in the American system against fraudulent corporations. These are:

a) Corporate probation.

Before this can be imposed, the following guideline should be considered and the court must order a term of probation in some circumstances including the following.

- If necessary to ensure satisfaction of other sanctions.
- If an organization of fifty or more employees lacks an effective program to prevent and detect violation.
- If the organization or high-level personnel participating in the fraudulent offence have been convicted of a similar offence in the past five years.
- If necessary to ensure that changes are made within the transition to reduce the likelihood of future fraudulent conduct.

b) Corporate rehabilitation

Corporate frauds frequently arise from defective control systems, insufficient checks, and balance within the corporation as well as poor communication systems. Their failings are sometimes deliberate and are made by the corporation to facilitate the commission of the offence or the avoidance of detection and sometimes the failings are in advertisement.

Either way, it is possible to go for legal orders to force corporations to correct fraudulent

policies and practices.[110]

c) Enforced adverse publicity as a sanction.

The doctrines of fraud control through deterrence, public disgrace, and incapacitation would operate much well in relation to fraudulent corporate offenders. The labelling hypotheses makes it unwise to cause publicity as a tool to punish corporate offenders.[111] Mass media advertisements setting out details of a corporation's fraudulent conduct, compulsory notification to shareholders and others by means of the annual report and a temporary ban on advertising can work as a punishment against the whole organization.

d) Individual directors.

Will putting company executives behind bars act as a deterrent to the commission of corporate fraud? The concern to enable companies to be prosecuted for fraud might be at variance with the popular 'cultural expectation' that individual directors should be made liable for fatal commercial disasters that arise from their decisions. The companies Act[112] provides for the liability of directors towards the company. The liability of directors arises from:

i. Ultra vires acts.
ii. Negligence
iii. Breach of trust
iv. Misfeasance

Thus where director go beyond their contractual duties and commit fraud then they should be sued to their grave if this is the only way to recover the money that they have looted.

4.2.5 Conclusion.

Punishing and regulating corporations may entail putting in place the following mechanisms.

- Compliance oriented enforcement.
- Defining corporate crimes as either real crimes or economic crimes.
- Self-regulation through company codes
- Checking on the activities of internal and external auditors who are largely the producers of corporate frauds. This can be by ensuring that they comply and conform to International Accounting Standards.
- Punishing corporations through the criminal as well as through the civil law.
- Introducing alternative sanctions to the fine such as corporate probation and rehabilitation, as well as adverse publicity in the Kenya Gazette and sanctioning individual directors and company auditors.

CHAPTER 5
CONCLUSION AND RECOMMENDATIONS.

5.1 CONCLUSION.

In **chapter 1** we found out that a corporation is an indigenous device for obtaining individual profit without individual; responsibility[9] we found that the term corporate fraud encompasses variety of crimes. the perpetrators of corporate rime are single individuals or groups of individuals. corporate fraud, commercial fraud and fraud relating to trades descriptions, pensions, health and safety, and securities all widely affect the public. The pressure is on the Kenyan corporate sector to deliver good governance.

In **chapter 2** we undertook a close look to corporate frauds in their contemporary and historical frauds. We discussed specific frauds including insurance fraud, tax invasion and corporate corruption. This also encompassed corporate crime, which is defined as corporate fraud that involves managerial direction, participation or acquiescence in legal business acts and what have been termed as economic crimes.

We also found that in their early stages of development companies pioneered new areas for trade and government shad interest in supporting these corporate activities. The rapid economic changes of industrialization entailed mainly companies expanding very quickly. The civil law was developed to offer support and protection to corporation. Companies were not easily found liable for crimes and any frauds that they committed.

The criminal law as it touched corporation was equally insensitive to the needs of expanding business[10].However, for the early part of history, the corporation laid outside the criminal law. The Roman Law supported the old idea. A Corporation could not therefore commit a crime because any crime would necessarily be ultra vires the corporation. A clear case can be made for imputing to such corporation social duties including the duty not to offend relative parts of the criminal law. We also found out that corporate fraud usually takes that forms of financial violations.

In the Chapter, we undertook case study of Massachusetts experienced in the 1990s under the Kenyan experience. I relation to insurance fraud we found that in Kenya, scheming smart lawyers, and doctors fleece insurance companies off money in the real sense past Stallion Insurance Company and Lakestar Insurance Company filed for bankruptcy the clientele of these companies lost their premiums when the companies went under liquidation. Stallion Insurance Company was wound up and Lakestar Insurance Company is currently under receivership.

We also discussed corruption in the corporate perceptive. The existence of situations of corruption in Kenya requires reducing the company`s in transparency.[11]it is often the case that employees who perform corrupt acts for the company expect the company to protect them.[12]the company and in particular its senior management duty first to effectively prohibit the practice of corruption in the company, even if it is to the company`s benefit. Likewise, employees, the mangers must feel responsible for eradiating situations of corruption within the company. we also undertook a Case Study of Tax evasion in the USA. We found out the tax havens are widely used to avoid corporate tax obligations and the high – income countries continue to reform the laws to reduce abuse. We found that tax havens receive a great deal of negative presses in early 2002 from a separate corporate evasion of corporate income tax liability by shifting the headquarters to a tax haven [13]the principal cause of all this is low Value Added Tax, which is essentially a sham ,activity that allows corporations to higher tax rates elsewhere by using tax haven addresses, each haven was to have a plan for corporations in place.OECD member counties might take action against tax havens beginning 2005 .

We found that Kenyan position is that foreign corporate entities simply do not pay tax. Strings of Asian companies have not been paying taxes. Tax evasion is the rife among Asian companies.

In chapter 3 we discussed corporate frauds in a manner. we found that corporate frauds in Kenya are events in which force or fraud are used to satisfy self –interest. Kenya corporations exercise enormous influence over social affairs and it is much more important to understand corporate fraud. We discovered that many Kenyan executives engage in fraud due pressure from society. The Kenyan companies act has numerous loopholes that facilitates fraud. The provisions of the Kenyan Companies Act are not adequate to prevent commission of fraud by directors.

We also found that when Kenyan companies are faced with blocked legitimate opportunities they may develop a subculture of law breaking. Kenyan corporations omit fraud because they

[9] Bierre, the Devil`s dictionary (Cambridge University press New York 1958) page 1

[10] See generally Reinman, J. the rich get richer and the poor get prison.3rd ed. (Allyn Balcon publishers, Boston 1995) pg. 345

[11] This can be by concealing information or perhaps misrepresentation in a county statements and tax returns and thereby violating the provisions of the Income Tax Act 470 Laws of Kenya.

[12] This would be interpreted by the others as a sign of weakness on the part of the management.

[13] US Treasury Report 2002

want to maximize their profit. In our case we can label Kenya corporation as inherently fraudulent. Nevertheless, the labeling theory is not a viable option to explain why Kenyan`s corporations engage in fraud. We should never underestimate, the moralizing social factors within corporations. There is no doubt that Kenyan corporate needs to be partially understood with respect to the organizing characteristic of different corporations. A full-blown theory of Kenyan corporate frauds needs to take account of various aspects of organization form and structure. We found that in Kenya, the social structure of the corporation enables executives to omit fraud. Kenyan businessmen may devise different forms of corporate mechanisms entailing fraud and misrepresentation, or they may cheat on their income tax. For Box[14] this makes the corporation inherently fraudulent.[15] However anomie is not good theory to explain Kenyan corporate fraud. The economic and social structure as well as political environments surrounding companies can become useful as a source of knowledge about corporate frauds as understanding corporations *per se. A*ccount must be taken of each of these macro-level phenomena in attempts to explain corporate fraud in Kenya.

In chapter 4 we looked at the current mechanisms available for regulating and controlling corporate activities. These we found to be dismal sine only two modes are available. These are fines and corporate punishment. Furthermore we also found out that the provisions of the companies Act[16] and in particular section 393 to 400 are inadequate.

5.2 REOMMENDATIONS.

5.2.1 markets and industry structure.

Kenyan corporate policy can thus produce extensive low-level offending. There is great evidence that Kenyan corporate fraud increases when industries are deregulated. The relationship between markets and corporate rime remains indeterminate. [17] the paramount economic priority of Kenyan companies is to be profitable. To this end our legislature should consider reviewing the current companies act[18] especially section 393 to 4000 relating to offense. These should be revised to include economic frauds as part of the offense that a corporation can do. This will go a long way in regulating corporate activities.

5.2.2 Accounts and Statutory Books

The companies Act requires that every company should keep proper books of account relating to its transactions and to make the greatest possible disclosure of its financial position in the published accounts so that an intelligent appraisal of its financial status can be made.

Books of account: To this end section 147 provides that every whether private or public must keep proper books of account

Place of keeping: all books of account must be kept in the registered office in Kenya or any other place within Kenya subject to the direction of the directors. If they have to be kept outside Kenya the registrar's consent must be obtained. The provision should be strengthened to make poling easier and efficient. The books shall be open for inspection by interested person subject to provisions of the Act.

Penalty for non-compliance: section 147(4) of the Companies Act provides that non-compliance by the directors to ensure that the books are kept shall attract a custodial sentence of up to 12months imprisonment or 10.000 fine or both. Increasing the fine to 50,000 should enhance this provision. This in itself will AT AS A deterrent measure to check unscrupulous directors.

Annual Account and Balance sheet: under the section 148 at every Annual General Meeting the directors shall lay before the company a balance sheet and a profit and loss account. The balance sheet and profit and loss account must give a fair view of the state of affairs as at the end of the financial year. The balance sheet and the profit and loss account must be in the form set out in part III of the 6th schedule of the companies Act. section 155 of companies Act provides that in the case of a company other than a banking company, two directors must sign every balance sheet on behalf of the Board of Directors of if there is only one, by that director. The provisions in relation to authentication of the balance sheet and profit and loss account should be reviewed to make them more stringent. this is to make sure that falsification of the entries in the balance sheet is not easy as the case under the present Act.

Statutory Books and Registers.

Every company is under statutory obligation to maintain the following books and registers at it registered office.

- Register of investments.
- Register of charges.
- Register of members.
- Index of members.
- Registers and index of debenture holders.
- Minutes books.
- Books of Accounts.

Sine these are the instruments that are used to omit fraud more measure should be put in place to scrutinize the way in which the books are filled and kept. If possible three copies of each book should be maintained and where applicable all transaction should be stored electronically and copies given to authenticate people each with a different password. This will go a long way in preventing omission of fraud by corporation against shareholders

Auditing.

The inherent complex nature and constitution of corporation necessitates the compulsory audit of its account, since the shareholders, who are the real proprietors are in general absentee 'owners' of the company. it is for this reasons that the Companies Act requires the auditor to communicate his findings to the members in form of a report. In this report the auditor is required to communicate his opinion and conclusion about the company's affairs. The professional body ICPAK (Institute of Certified Public Accountants), places the following objectives on the auditors:

. That after the end of his audit and after the report is submitted; he gives a management letter in which he will communicate to the directors' problems encountered and the solution thereof. That is, he is requires to give advice to the management on such matters as: -

[14] See general, Box, S Recession, fraud and punishment 3rd ed, (Macmillan Publishers, London (1987)

[15] Since it is necessary to operate in an uncertain and unpredictable environment such that its purely legitimate opportunities for goal achievements are sometimes limited and constrained.

[16] Cap 486 Laws of Kenya.

[17] This analysis is useful sine it points loopholes in this area

[18] See generally the provisions Companies Act Laws of Kenya

i.) Internal control system where they need to be improved or hanged altogether and the alternatives
ii.) The company's planning system –such as tax planning, investments planning and manpower planning.
iii.) The auditor, during the course of his audit, should detect errors and frauds and bring these to the attention of the management in as much as they affect the company's fair and true view.
iv.) The auditors should pay frequent visits to the client both as a means of preventing errors and fraud and also to boost the morale to work and thus improve the company's operational efficiency.

The auditor can achieve these objectives by:

a. Critically reviewing the books of account and reconcile these with the underlying records such as invoices and L.P.Os.
b. Gather sufficient relevant and reliable evidence and form an opinion based on this evidence gathered.
c. Ascertain that the company's balance sheet and profit and loss account agree with underlying records by making tests on Accounts transactions and making enquires.
Make a critical review of the company's balance sheet accounts in order to ensure that this have been prepared according to the Companies Act requirements.
d. Critically analyze and check the companies' systems with a view that they are operating well.
e. Check the company's books and request acknowledge from those keeping such books.
f. Make surprise visits to the company's premises so as to access the company's procedural operations and efficiency.

All these provisions if well adhered to will ensure that fraud is not perpetrated by directors in collusion with auditors.

5.2.3 Company codes

Initiatives are underway to develop codes of conduct for major corporation in Kenya. Soon companies can adopt local versions of the guidelines used elsewhere such as the OECD countries. However, checklists are not sufficient. The signing of externally imposed rules cannot in itself deliver good governance. Good corporate governance must emerge from deep within the corporation.
Today's complex organizations have multiple stakeholders. Directors and managers are accountable not just the shareholder but to a multitude of interested parties all of which are affected by and affect the running of the business. Company codes in themselves provide a form of protection. it's well known that employees are forbidden to pay bribes, they less likely to receive demands but experience has shown that codes in themselves are not enough and attention should be directed more on the dilemma of enforcement.

5.2.4 **The Regulatory Structure and the Production of Fraud.**

It is important to address regulation in the context of understanding the cause of corporate fraud. We need to understand how a corporation's organization, goals and structure relate to fraud.[19]
The economic structure of a society may also be conducive to corporate fraud. Many corporate frauds in Kenya are the product of market structure.[20] The quest for profits may also lead to corporate frauds. The emergence of large corporation provides them with opportunities to commit fraud in several ways.[21] Although the costs of corporate frauds in Kenya are exorbitant it generally receives lenient treatment from the criminal justice system. Enforcement agencies in Kenya, for their part are generally reluctant to prosecute corporate offender. In short, in case of corporate fraud in Kenya, prosecution is uncommon; conviction is rare and harsh sentences almost non-existent. To remedy this anomaly regulation of corporate entities should be checked. To this end before a company is registered the registrar of companies must scrutinize its articles and memorandum of association. This is to check the emergence of briefcase companies whose aims is to defraud the common man.

5.25 Compliance oriented enforcement.

Business and particularly corporations are typically amoral calculators. They should therefore be geared towards complying with the provisions of the Companies Act. Failure to follow this provision should be sanctioned by automatic deregistration. It is possible in law and in its enforcement to clarify legal responsibility in and around corporation.[22]

5.2.6 a case study for enforced self-regulation.

Direct regulatory enforcement[23] is one outstanding doctrines of fraud control by the public disgrace, deterrence, incapacitation, and rehabilitation can be successfully applied to corporations.[24] In context of corporate fraud, deterrent sentencing should not serve to exacerbate social inequality.[25] Corporations should come up with their in house company codes, which should help them to regulate their corporate affairs.

5.2.7 punishing corporations

One distinctive problem in the area of corporate fraud is the issue of how such non-human legal personalities should be punished if they are convicted of fraud. To this end our Cap 486 should distinguish between fraud against social regulation and fraud against economic regulation. There is a significant difference between crimes against social regulation and crimes which are against economic regulation. The regulation of corporate fraud is an ever-changing process and at any period, some corporate fraud will be against the interests of capitalism.[26]corporate fraudsters in Kenya should be tried for economic crimes against the people of

[19] See generally, Boris, E and Prueg B Corporate fraud in global perspective: Invisible no more (Routledge publishers, London 1996) PG 201
[20] Undue influence, concentration of economic, and market power, may give rise to abuse of such power and to deceptive and unfair trade practices.
[21] Distribution of authority among individuals' representatives' increases opportunities for such representatives to embezzle corporate funds or assets, and to deceive and exploit other individuals who do business with the corporation.
[22] The issue of collusion is both a red herring and somewhat offensive. While victim blaming is common place in response to corporate crime it rarely stands up to any scrutiny and serve only to divert attention from the real cause of any particular illegality.
[23] This should be by prosecution, license supervision and adverse publicity, or other means.
[24] See generally, Bright, J: Turning the tide (Demos Publishers, London 1997)
[25] See generally, Fisse, B and Braithwaite.J: Corporation, Crime and Accountability (Cambridge University press, Cambridge 1993)
[26] See generally, Yoder, A. criminal sanctions for corporate illegality journal of criminal law and criminology (1978) pg. 40-58

Kenya and the government at large. To achieve this goal we should revise our penal laws[27] include these types of offences. The Kenyan legislature should take a leaf and enact proper laws to prosecute serious fraud. A department to prosecute serious economic frauds should be created. This department to prosecute serious economic frauds should be responsible for investigation of large and complicated frauds involving limited companies and banks, and also offences of public sector corruption.

The criminal courts.

Both Kenyan criminal laws and English criminal law have developed the fiction of corporate personality. A corporation can only act through individual persons. No Kenyan corporation has been successfully prosecuted for fraud despite the fact that many have engaged in fraud. The criminal courts should be at the forefront in prosecuting corporate fraud. Attorney General should listen to public outcry and undertake to prosecute corporate offenders.[28]

Corporate fines.

The fines as provided by cap 486 are inadequate. corporate offenders should be followed and sued to their grave if that is the only to recover the looted funds.

Corporate probation.

This is not provided for in our companies Act. Perhaps this should be provided for so that companies are provisionally registered subject to their compliance with the provisions of the Act. If they fail to meet the requirements of the Act within a stipulated period, then they should be denied registration.

Corporate rehabilitation.

Corporate frauds frequently arise from defective systems, insufficient checks, and balances within the corporation as well as poor communications systems. This should be improved to make sure that they are compliant. The doctrine of fraud control through deterrence, public disgrace, and incapacitation would operate much well in relation to fraudulent corporate offenders.

Conclusion

Corporate frauds can be controlled if proper mechanism are put in place to check activities. These should aim at improving efficiency and utility of a corporation. To this end corporation should strive to hire highly competent and diligent employees as well as directors. These are the ones who determine the returns of a corporation at the end of each financial year. To eradicate corporate fraud there must be good corporate governance. Good corporate governance should start with the directors themselves before it can spill over to the other employees. Stakeholder management is also an issue of contention since no major company can ignore the interest of the employees, the government, the wider community as well as the media

Leadership plays crucial role and therefore directors must provide a strong and vibrant leadership that sets example. This in itself goes a long way in the delivery of benefits more than any other measure. The imperatives of efficiency, probity, responsibility and transparency must flow down from the top. There is need for a strong sense of ethics. Businessmen need to focus on developing long-term success based on sound ethical principles. The lost values of hard work and decency must be recaptured.

Finally, good corporate is extremely difficult to effect in the absence of good national governance. Business operate within a wider framework of regulations. Where this framework is perceived as weak, non-transparent or skewed towards particular interests, corporation will struggle to implement their own governance however well intentioned. Good corporate governance must emerge from within individual corporation and must be part of 'bones and bloodstream' of the organization. Codes and regulations have their role but should be a manifestation of good business practice and not a cause. The first step is to ensure that corporate governance systems are geared to deliver ethical business success otherwise directors will be no more than *'ornaments on the corporate Christmas tree*'

[27] See generally the provisions of the Penal Code cap 63 Laws of Kenya on punishment

[28] See generally, Klich, A "Bribery and Fraud in Economic in transition: the US foreign Corrupt Practice Act "Stanford Journal of Journal of International Law 1996 vol.32(1) page 121-127.

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