The Efficacy of using Governance Audits as a Risk Management Tool in Kenya

Musili Wambua*, Seth Wekesa** & Melisa Ng'ania***

Abstract

Corporate Governance (CG) as a concept in Kenya gained great popularity as a result of the wake of the collapse of many corporations due to poor governance. Similarly, the government institutionalized CG as a way to enhance the growth and development of the economy by ensuring that corporations maintain a competitive advantage over the rest. Similarly, good CG practice is an incentive for Multi-National Corporations (MNCs) to invest in Kenya. With this background, the government took deliberate measures to streamline good CG practices. Key to these incentives was the enactment of the Companies Act, 2015. The Companies Act, 2015 requires corporations to assess the extent to which corporations have complied with good CG practice. To fully operationalize the requirement by the Companies Act, the Mwongozo Code and the Code of Corporate Governance Practices for Issuers of Securities to the Public (CMA Code) require corporations to conduct a governance audit annually. The Codes provide the parameters by which a governance audit should be measured. The paper highlights the importance of conducting a governance audit from a risk management perspective. It argues that the

parameters for conducting governance audits as identified by the Mwongozo and CMA Codes in Kenya are sufficient in assisting corporations to assess their level of compliance with sound CG and management of risk. It also highlights the challenges that corporations encounter as they undertake governance audits and proposes recommendations to help mitigate the challenges to ensure that corporations fully benefit from the time and resources they invest in while undertaking a governance audit of their governance structures, policies, systems and procedures.

*LL. B (Nbi); Dip. Law (KSL); LL.M(Lon); MBA (USIU); LLD. (Ghent). Professor of Law at the Faculty of Law, University of Nairobi and a partner at Prof. Musili Wambua & Co Advocates and Africa Law Chambers LLP. He has taught and published in the area of Corporate Governance.

**LL. B (UoN), LL.M(UoN), LL.M (Pretoria), LL. D (Pretoria). Lecturer at the University of Nairobi, Faculty of Law and an Advocate of the High Court of Kenya. He is a Partner at Munyao, Muthama and Kashindi (MMK) Advocates. His research and practice interests are in administrative and constitutional law, corporate governance, legal compliance audits, democracy, and human rights.

***LL. B (MUK), Dip in Law (KSL), LL.M (UoN).

1. Introduction

The growth and development of Corporate Governance (CG) in Kenya was not informed by any scandals, as was the norm in other jurisdictions.[203] CG was seen as a way in which the government would enhance and

203. Dr. Jacob Gakeri, 'Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities' (2013)6(3) International Journal of Humanities and Social

create a competitive economy both locally and internationally. However, over time, corporations, especially state-owned ones, were plugged into mismanagement leading to the need for reforms especially on how the corporations were managed effectively and efficiently.[204] These reforms were also entrenched in the Constitution of Kenya 2010 as well as in Guidelines issued in both the private and government sectors, including *Mwongozo* Code for State Corporations and CMA Code for public listed companies. These two codes require corporations to undertake a governance audit annually in order to assess their level of compliance with the regulatory framework, governance structures, systems, policies and procedures.[205] This makes the conduct of governance audits a regulatory requirement.

Governance audit refers to an independent assessment of an organization to express an opinion on its governance practices, systems and process.[206] This assessment can only be undertaken by an independent person to give an objective view.[207] For a governance audit to achieve its purpose, the governance auditor has to interrogate and evaluate the corporations' policies, processes, structures and systems to determine how the same operate to meet the overall mandate.[208]

The requirement for corporations in Kenya to conduct a governance audit is historical and the same can be traced to the growth and development of company law in the country. The law that governed operations

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Science 94<*http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf*> accessed on 13th October, 2021.

204. Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructures Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' (2007) 31(1) Fordham International Law Journal 34 <http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf> accessed on 13th October, 2021.

205. See Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> XI accessed on 5th January, 2023.

206. The Institute of Certified Public Securities of Kenya Governance Guidelines 003, Reg 4.5.

207. Ibid.

208. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> 50 accessed on 5th January, 2023.

of companies before the enactment of the Companies Act, 2015 was the Companies Act, 1962 which was based on the United Kingdom Companies Act of 1948, a statute that was not updated to be in tandem with modern ways of doing business.[209] The Companies Act 1962 was blamed for being weak and faulted for providing a fertile ground for poor CG to thrive.[210] Indeed, during this regime, many corporations collapsed due to poor CG.[211] There was also a need to attract foreign investments and make Kenya a globally competitive market by making the country an international financial and investment destination of choice.[212] This called for groundbreaking reforms, which included, amongst others, enactment of a new law to govern and regulate the operations of companies in the country.

The Companies Act 2015 brought in the requirement for the institutionalization of CG by corporations.[213] Furthermore, corporations are required to annually assess the extent to which they have observed the policies as well as strategies to achieve good CG.[214] With these new requirements, the State Corporation Advisory Committee (SCAC) and the Capital Market Authority (CMA) had to align the codes to be in tandem with the Companies Act, 2015. This led to the introduction of the requirement for corporations to conduct governance audits on an annual basis to check their level of compliance with sound and best CG principles and practices.

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209. Lois M. Musikali, 'The law affecting corporate governance in Kenya: a need for review' (2008) International Company and Commercial Law Review 1 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1275308> accessed on 13th October, 2021.

210. Ibid.

211. Wairange Loise Ruguru, 'The Link Between Corporate Governance Failure and the Collapse of Major Private Companies in Kenya' (M Law Thesis, University of Nairobi) <http://erepository.uonbi.ac.ke/bitstream/handle/11295/108832/wairange_The%20Link%20Between%20Corporate%20Governance%20Failure%20and%20the%20Collapse%20of%20Major%20Private%20Companies%20in%20Kenya.pdf?sequence=1&isAllowed=y> accessed on 25th October, 2021.

212. Ibid.

213. Lois M. Musikali, 'The law affecting corporate governance in Kenya: a need for review' (2008) International Company and Commercial Law Review 1 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1275308> accessed on 13th October, 2021.

214. Companies Act No. 17 of 2015, s. 770.

2. Importance of Conducting Governance Audits

Corporations derive benefits from conducting governance audits. It is neither a public relations exercise nor a routine exercise. Some of the benefits of conducting a governance audit include:

It acts as a routine health check for the corporations. Just like human beings, corporations need to be assessed to confirm whether they are 'healthy' and fit to conduct their business as described within their governance structure and strategy. The only way to verify this is by conducting a governance audit regularly. Coupled with this is the fact that the governance audit acts as a self-assessment tool for a corporation. The corporation on its own is not able to discern whether it is operating on sound CG principles. A governance audit, therefore, acts as an effective assessment that gives necessary assurance to the corporate management, regulators as well as stakeholders that the corporation is sustainable and safe to operate in a competitive world.

Undertaking a governance audit is also important to the board of directors to be able to ascertain that a corporation is on the right track with its governance agenda. This is crucial for a corporation noting the fact that the board is vested with the responsibility of ensuring that the corporation is run and managed on sound CG principles. This assurance can only be obtained through conducting a governance audit.

The conduct of governance audit also helps the board as well as the management to give assurance and inspire the confidence of the shareholders, the creditors and all the stakeholders. This is critical because shareholders contribute equity to the wellbeing of the corporation and are considered as a lifeline of the corporation.[215]It is therefore important to

215. Shafi Mohamed, 'The importance of effective Corporate Governance' (2004) SSRN Electronic Journal 1<https://www.researchgate.net/publication/228237979_The_Importance_of_Effective_Corporate_Governance/link/5a657b864585158bca51df1b/download> accessed on 28th October, 2021.

give the shareholders the satisfaction that the corporation is functioning well and their investment is safe. Most corporate scandals have been blamed on poor CG.[216]

Engaging in governance audit makes corporations compliant with international best CG practices. Globalization has changed the scope and nature in which corporations operate. Most corporations must think globally but act locally. Thus, conducting a governance audit ensures that the corporation is at par with other similar corporations' world over and can compete as well as trade without any hindrance. This will therefore help corporations to maintain a competitive advantage and remain relevant within the corporate space globally.

Conducting a governance audit also helps a corporation in risk management. It acts as a risk management tool. This is because it helps corporations to identify strategic and functional gaps and areas for improvement within the corporation that requires to be attended to before it becomes problematic. This is the focus of this paper.

3. Legal And Regulatory Requirements For Governance Audits In Kenya

The need to conduct a governance audit is a requirement that is entrenched in law. The corporations are therefore required to comply with this requirement. As discussed above, the need to conduct a governance audit regularly is informed by the fact that, for corporations to achieve good CG, it is key that all stakeholders within the corporate realm are accountable for their actions as well as fulfill the responsibilities that are bestowed upon them by law.[217]

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216. Andreas M. Fleckner and Klaus J. Hopt, *Comparative Corporate Governance: A functional and international analysis* (Cambridge University Press, 2013) 5.

217. Ngoyen Hou Cuong, 'Actors causing Enron's collapse: An investigation into corporate governance and company culture' (2011) 1(3) Corporate Ownership and Control 585 <https://www.researchgate.net/publication/228318972_Factors_Causing_Enron's_

The Constitution has established the national values and principles of governance as an impetus to measure sound CG and all participants in a corporation should ensure that they work and operate within the confines set by the Constitution for the reason that the Constitution sets the bear minimum.[218] Among the values and principles that are relevant to CG include principles of responsibility, integrity, transparency and accountability which if observed in totality, amounts to good governance.[219]

Further, the principles of good governance have been entrenched in the management of corporations. The *Mwongozo* and CMA Codes underscore the need for the board to ensure that all the deliberations, decisions as well as actions they take are founded on the core values of good governance, which include responsibility, accountability, fairness and transparency.[220] As regards responsibility, the board should assume responsibility for the assets of the corporation by ensuring that they are protected from waste, loss, damage, misuse, theft and misappropriation. It is also the responsibility of the board to ensure that the books of accounts of the corporation are maintained in an accurate manner, which reflects the true financial position of the corporation.

On accountability, the *Mwongozo* and the CMA Codes obligates the board to justify to stakeholders the decisions and actions they take on behalf of the corporation. This is significant because it shows and proves that there are people who are in control of the corporation, a fact that gives comfort not only to shareholders, but also stakeholders, investors and regulators.

Collapse_An_Investigation_into_Corporate_Governance_and_Company_Culture/link/5927d90ca6fdcc444350b618/download> accessed on 28th November 2020.

218. Constitution of Kenya 2010, Art 10.

219. Ibid.

220. See Public Service Commission & State Corporations Advisory Committee ‘Mwongozo: The Code of Governance for state Corporations’ (2015). <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> 50 accessed on 5th January, 202351 and Code of corporate governance practices for issuers of securities to the public 2015 Reg 5.1.1.

The board should, in making its decisions, ensure that it considers the interest of all stakeholders. Fairness should also be the cornerstone in the decision-making process on matters touching on the management of the corporation. This will go a long way in helping to manage and minimize conflicts within and without the corporation. It will also promote a sense of ownership by the stakeholders for the well-being of the corporation.

The Companies Act also obligates the audit committee of a listed corporation to assess on an annual basis the extent to which a listed corporation has observed good governance principles.[221]

The State Corporations Act 1986 was enacted to make provisions for the establishment of state corporations, for control and the regulation of state corporations.[222] The Act establishes the State Corporations Advisory Committee (SCAC) whose mandate includes, amongst others, to review and investigate the affairs of state corporations.[223] In discharging this statutory mandate, SCAC provides oversight on the implementation of the *Mwongozo Code* by ensuring that state corporations comply with it through the undertaking of governance audits as well as enforcing any consequences for non-compliance.[224]

The Capital Markets Authority (CMA) is mandated with the responsibility of promoting, facilitating and regulating the development of orderly, fair and efficient capital markets.[225] In discharging its mandate, the CMA, under the CMA Act, developed the CMA Code to regulate both private and public corporations that are listed on the capital markets.[226]The Code requires listed companies to conduct a governance audit annually.

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221. Companies Act, 2015, s 770(1)(e).

222. See the long title of the State Corporations Act Cap 446 of the Laws of Kenya.

223. State Corporations Act Cap 446, ss 26 and 27.

224. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 5.4 accessed on 5th January, 2023.

225. Capital Markets Act No 3 of 2000.

226. Capital Markets Act No 3 of 2000, s 11(3)(d).

The Certified Public Secretaries of Kenya Act establishes the Institute of Certified Secretaries (ICS), which has a statutory mandate to promote good CG.[227]To fulfill its statutory mandate as well as promote its vision and mission, ICS deemed it necessary to develop a code of governance for private organizations to address governance challenges within the private corporations in Kenya.[228] This Code, therefore, regulates private corporations that are not listed on the stock exchange.

The CMA Code and the *Mwongozo* provide that a governance audit shall be carried out annually to confirm that a corporation is operating on sound governance practices.[229] The governance audit is to be conducted by a competent and recognized professional accredited by the ICS.[230] The main role to be undertaken by the governance auditor is checking on the level of compliance with sound governance practices.[231] The requirement for the accreditation of a governance auditor by ICS is informed by the fact that the persons who conduct the governance audit are persons who are qualified and equipped with the necessary technical competencies and skills. Similarly, having a code that binds them to discharge their mandate entrenches the need for accountability and professionalism.[232] The ICS has also developed governance and audit guidelines to guide the governance auditors when conducting governance audits to enhance professionalism, uniformity and constituency in the conduct of the governance audit.[233]

227. Certified Secretaries of Kenya Act Cap 534 of the Laws of Kenya, s 3.

228. Institute of Certified Public Secretaries of Kenya, 'The Code of Governance for Private Organizations in Kenya' 2014.

229. See Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015). <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 1.12 accessed on 5th January, 2023.

230. See Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015). <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg. 1.13 accessed on 5th January, 2023 and Code of Corporate Governance for Issuers of Securities to the Public 2015 Reg 2.11.

231. Ibid.

232. Institute of Certified Public Securities of Kenya Governance Audit Guidelines GG 003.

233. Ibid.

4. Relationship Between Governance Audit Parameters And Risk Management

The *Mwongozo* and CMA Codes prescribe eight (8) parameters that governance audit should cover.[234] These parameters include leadership and strategic management; transparency and disclosure; compliance with laws and regulations; communication with stakeholders; board independence and governance; board systems and procedures; consistent shareholder and stakeholder's value enhancement; and corporate social responsibility and investment. The parameters guide the governance auditor while undertaking the audit exercise. The next section examines how each parameter could be utilized to manage risk within a corporation.

4.1. Leadership And Strategic Management

It has been argued that the success or failure of any organization rests on its leadership.[235] Corporations may collapse particularly if the leadership suffers from the inability to respond or identify threats, overestimating their ability to control a corporation's external environment in cases where the leaders fail to distinguish and separate their personal interests from those of the corporation.[236] The *Mwongozo* and CMA Codes underscores the fact that the leadership of the corporation rests with the board.[237] The board has to provide the overall leadership and is responsible for the strategic direction of the corporation. The board is accountable for the mission and values that guide and shape the corporation and has the ultimate responsibility of ensuring that the corporation has adequate resources to fulfill its mandate. The board is

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234. Ibid.

235. Sydney Finkelstein, Bert Cannella and Donals C. Hambrick, *Strategic Leadership: Theory and research on executives, top management teams* (Oxford University Press, 2009) 1.

236. Ibid.

237. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 2.1.1 accessed on 5th January, 2023.

also mandated to determine the mission, vision, purpose and core values of the corporation. These have to be strategic and determinate to achieve the goals of the corporation. In essence, leadership and strategy are the core and driving forces for the proper functioning of a corporation. Leadership and strategic management are important for the corporation in managing risk in that they will help the corporation to confirm whether they are in harmony with their strategy as well as the modality of achieving the same. Similarly, it helps the leadership to identify any drawbacks with the strategy adopted and make fresh strategies that are more relevant to the mandate or core business of the organization. The governance audit assesses the importance of the separation of roles between the board and management. It establishes whether the board can provide strategic direction and formulate appropriate policies for management to implement. It checks the effectiveness of the mechanisms in place to enable the board to monitor how management implements board resolutions and policies including risk and compliance-related policies. It also assists the board to assess the mix of skills, competencies and experiences to steer the organization in the right direction. Without proper leadership, a corporation is bound to fail.

However, there is challenge with leadership in some corporations, such as family businesses where those in leadership are not appointed because of the expertise that they provide, but because of the personal or family interests in the corporation. As such, it would be a challenge for such leaders to offer guidance to steer the strategic development of a corporation. The downfall of Tuskys supermarkets limited has been blamed on family wrangles.[238] Being a corporation owned entirely by a family, it was difficult to have people at the helm of its management who are professional and qualified to steer the corporation.[239]

Similarly, most of the appointments to board members of state corporations are not done competitively. Some of the appointments are done as political rewards to serve the political interests of their appointing authorities. It has therefore been argued that as a result, persons appointed to the various boards do not have the competence required, a factor that ends up having a ripple effect on the functioning and management of corporations.[240] This is a threat to the corporation for the reason that the board offers strategic and instrumental leadership to the corporation and, as such, having a board that does not understand the strategic needs of the corporation can be detrimental. The issue of appointment to the boards of state corporations and parastatals has been a subject of litigation in Kenyan Courts. In the case of *Katiba Institute & another –vs- Attorney General & another; Julius Waweru Karangi & 128 others (Interested Parties),*[241] the Court held that appointments to state corporations and agencies are appointments in the public service and, as such, must adhere to the tenets of the constitution. In reaching this decision, the Court relied on the decision of *Community Advocacy and Awareness Trust & others –vs- AG & 6 others*,[242] where the Court appreciated the complete shift in the way appointments used to be done as had been ushered by the Constitution of Kenya, 2010 by stating that:

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238. Tonny Omondi, 'Tuskys in the footsteps of collapsed Nakumatt and Uchumi' The East African (Nairobi, 10 September 2020) <https://www.theeastafrican.co.ke/tea/business/tuskys-in-the-footsteps-of-collapsed-nakumatt-and-uchumi-1936046> accessed on 29th October 2021.

239. Brian Wasuna, 'Kenya: How Tuskys' directors lived large as the retailer struggled' Daily Nation (Nairobi 25 February 2021) <https://allafrica.com/stories/202102250444.html> accessed on 29th October 2021.

240. Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructures Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' (2007) 31(1) Fordham International Law Journal 34. <*http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf*> accessed on 13th October, 2021.

241. [2021] *eKLR.*

242. [2012] eKLR.

27th August 2010 ushered in a new regime of appointments to public office. Whereas the past was characterized by open corruption, tribalism, nepotism, favoritism, scrapping the barrel and political patronage, the new dispensation requires a break from the past. The Constitution signifies the end of the 'jobs for the boys' era. Article 10 sets out the values that must be infused in every decision-making process including that of making appointments.

4.2. Transparency And Disclosure

The CMA and *Mwongozo* Codes underscore the importance of a corporation being transparent and disclosing all its dealings.[243] The key underlying factor for a corporation to be transparent and disclose all its dealings is hinged on the fact that it is an important aspect of corporate leadership and management because it helps corporations to sustain the confidence of investors, stakeholders as well as the wider society.[244] It has also been observed that weak disclosure can contribute to the practice of unethical behavior, weakening of market integrity and loss of investor confidence.[245] Disclosure is important because it allows stakeholders to understand a corporation's activities, policies and performance concerning environmental and ethical standards as well as the relationship with communities where the corporation operates.[246]

243. See Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015). <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Chapter 2 accessed on 5th January, 2023 and Code of corporate governance ractices for issuers of securities to the public 2015, chapter 7.

244. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 7.0 accessed on 5th January, 2023 and code of corporate governance practices for Issuers of securities to the public 2015, Reg 7.

245. Code of corporate governance practices for issuers of securities to the public 2015, Reg 7.

246. Ibid.

Transparency refers to the degree to which information flows freely within an organization, among managers and employees, and outward to stakeholders.[247] Transparency exists when information is assembled and made readily available to other parties. This helps in creating an informed and communicative environment, which is conducive hence enabling greater cooperation among all stakeholders in a corporation.[248] Transparency takes a two-prone approach, internal and external. Internal transparency ensures that the right information is put together with the right person at the right time whereas external transparency entails the communication of the corporations' values to the customers and consumers.[249]

The *Mwongozo* and CMA Codes require that corporations disclose the dealings of the corporation both internally and externally.[250] These include amongst others disclosing the number and name of board committees established, the board charter, the corporations' policy on procurement, the board composition and the corporations' compliance with laws and regulations. A reading of these Codes demonstrates that, indeed, everything and anything about the corporation has to be made public. This is important from a risk management perspective in that it will help the corporation to gain legitimacy from its shareholders and stakeholders who are the lifeline of the corporation. It will also help the corporation attract and maintain investors. Conducting a governance audit to assess the corporations' compliance with transparency and disclosure helps a corporation to strengthen its relationship with its stakeholders for the reason that the stakeholders will be aware of the

247. Benjamin Fung, '*The Demand and Need for Transparency and Disclosure in Corporate Governance'* (2014) 2(2) Universal Journal of Management 72 <http://www.hrpub.org/download/20140105/UJM3-12101630.pdf> accessed on 28th November, 2020.

248. Ibid.

249. Ibid.

250. See code of corporate governance practices for issuers of securities to the public 2015 and Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> 50 accessed on 5th January, 2023.

dealings with the corporation. The strengthening of the relationship with the stakeholders also helps a corporation to maintain a competitive advantage against its competitors because a corporation's customers will transact freely with the corporation, as they will feel that there is nothing that the corporation is doing behind their back. However, it would be important for corporations to manage and set appropriate apparatus to determine and manage what can be disclosed and how it can be disclosed. Sometimes too much information may be catastrophic to the corporation because competitors may use the said information to the detriment of the corporation.

A good example is the procurement laws, policies and procedures of most corporations that have always come under sharp scrutiny. This is because most of the procurements have been done without following the law and, as a result, have ended up costing the corporations their existence. Indeed, the collapse of Nakumatt and Uchumi supermarkets has been blamed on three major reasons; mismanagement, blind expansion without a strategy and theft of both cash and products by employees, owners and the management.[251] The same reasons were equally blamed for the collapse of Tusky's supermarket.

4.3. Compliance With Laws And Regulations

The CMA and *Mwongozo* Codes underscores the need for corporations to ensure compliance with the Constitution, all applicable laws and regulations, national and international standards as well as its internal policies.[252] To ensure compliance, the board of corporations should ensure that they develop and implement a legal compliance strategy, which ensures that the corporation complies with all applicable laws, regulations

251. Ibid.

252. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Chapter 8 accessed on 5th January, 2023and code of corporate governance practices for issuers of securities to the public 2015, Reg 2.1.

and standards. This can be done by ensuring that the compliance strategy is aligned with the operations of the corporation. The legal compliance strategy provides internal procedures and monitoring systems that promote and enhance compliance with relevant laws and regulations and assign the responsibility for compliance to specific functional units. Most corporations undertake a legal and compliance audit to be sure that the corporation is legally compliant.

Mwongozo and the CMA Codes require corporations to undertake an independent legal compliance audit after every two years to establish their level of compliance with relevant laws and regulations. The audit should be conducted by a legal professional in good standing with the Law Society of Kenya.[253]

A legal compliance audit is a critical tool of risk management for corporations. It assists the corporation to check its levels of compliance with the relevant legal and regulatory framework and internal policies and procedure manuals. The purpose of a legal audit is to identify any legal liabilities and risks facing the corporation in advance and come up with a way of preventing prospective suits against it.[254] It ensures the corporation is and remains compliant with the relevant legal and regulatory framework. It also provides the corporation with the opportunity for improvement in various functional and operational units. The audit exercise helps the organization to identify gaps in its operations and propose specific recommendations that will help the corporation to minimize legal risks and ensure it conducts its operations as per the Constitution of Kenya

253. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg. 1.3 accessed on 5th January, 2023and code of corporate governance practices for issuers of securities to the public 2015, Reg 2.11.

254. See ISSAI Implementation handbook on compliance audit *<https://static1.squarespace.com/static/57019a6db6aa607cbb909ab2/t/58dc5ee18419c2c05f88b427/1490837241649/ISSAI+Compliance+Audit+Implementation+Handbook.pdf>* 4 accessed on 29th October 2021.

2010, all relevant laws, regulations, policies and guidelines. The board should ensure the audit findings and recommendations are implemented to address any areas of non-compliance.

The other important aspect in enhancing compliance with laws and regulations is the legal compliance matrix/register. The matrix identifies the relevant laws and regulations that affect each functional unit within the corporation. It lists specific provisions that impose a duty and obligation on the specific departments within corporations and the consequences of non-compliance with the relevant provisions of the law. It also highlights the compliance status of various functional units with the relevant provisions of the law. The status could be either compliant, partially compliant or non-compliant. The corporation should monitor and keep updating its legal compliance matrix regularly to capture the changes in the legal, regulatory and policy requirements in its sector. Besides, the corporation needs to cascade the legal compliance matrix to the individual user departments for compliance.

Legal audits are essential for business. The risks of not conducting an audit are too high to ignore. Conducting an audit is more than beneficial - it is necessary. If management discovers latent legal problems during an audit, they can fix the problems before the corporation incurs any liability. Not only can future legal costs be reduced, but a legal audit can also reveal unknown business opportunities. Overall, a legal audit can help a business achieve its goals with the least risk to its owners or shareholders.

Failure to prepare, implement and update a legal compliance register may lead to an increase in cases of non-compliance with relevant laws and regulations affecting the operations of the corporations. This is because the corporation may remain unaware of the full spectrum of its legal compliance obligations and the concurrent effects of non-compliance. Non-compliance with laws may result in litigation which may increase the legal costs for the corporation. Besides, the corporation may not properly and effectively roll out preventive lawyering mechanisms without a legal compliance register which is an effective tool in such an exercise.

4.4. Communication with Stakeholders

The *Mwongozo* and CMA Codes explain the need for effective stakeholder engagement and management because of the role they play in the achievement of the strategic objectives and mandate of the corporation.[255] Stakeholders include shareholders, employees, suppliers, partners, customers, regulators, government, media among others.[256] Transparency and effective communication with stakeholders is important in building and maintaining trust thus enhancing the relationships with stakeholders. The governance audit assesses the frameworks and mechanisms in place to manage stakeholders within the corporation. It examines the adequacy and efficiency of the policies and procedures in place to enhance stakeholder management through setting up proper communication channels for sharing relevant information. An effective stakeholder engagement framework will contain mechanisms for resolving disputes among stakeholders in an effective, efficient and expeditious manner.

Failure to develop and implement an effective stakeholder engagement framework may expose the corporation to reputational risks for failure to address certain needs of stakeholders. It may also lead to some rights and the legitimate interest of stakeholders and shareholders not being identified and respected to enhance trust and confidence in the operations of the corporation. Lack of a proper framework may lead to slow and ineffective resolution of disputes among stakeholders.

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255. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 4 accessed on 5th January, 2023.

256. R. Edward Freeman, "Stakeholder theory of the modern corporation" <https://academic.udayton.edu/lawrenceulrich/Stakeholder%20Theory.pdf> 38 accesed on 2nd November, 2021.

4.5. Board Independence And Governance

The *Mwongozo* and CMA Codes emphasize the fact that the board is the single most important institution in CG.[257] As such, corporations should as a matter of principle ensure that the board comprises qualified and competent members who are capable of exercising objective and independent judgment as well as a board that is keen on guiding the strategic development of the corporation.[258] The recruitment and appointment of board members should ensure that it takes into consideration diversity, competency and skills as well as ensure that there is in place board members who are cognizant of the fact that they owe their duties to the corporation and not their nominating authority, especially for public corporations. The CMA Code goes ahead to give criteria that should be followed to ensure that an independent and competent board is in place.[259] The Companies Act has gone a step further to codify the duties of directors which include the duty to exercise diligence, skill and reasonable care, to act within powers, to avoid conflict of interest, to exercise independent judgment, not to accept a benefit from third parties and to promote the success of the corporation.[260]

The governance audit examines the policies and procedures established to enhance the independence of the board members within the corporation. Some of the procedures include board members are required to disclose and register any conflict of interest on the agenda items before the meetings start. It is also important for the board to have independent board members who bring in an independent and objective approach to board decisions to minimize risks arising from the conflict of interest or

257. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Chap 1accessed on 5th January, 2023.

258. Ibid.

259. Code of corporate governance practices for issuers of securities to the public 2015, Reg 2.4.1.

260. Companies Act 2015, s 140.

undue influence from external parties. The audit also checks the tenure of independent board members to ensure they do not overstay on the board. Long tenure may impair the independence of the board members.

An independent board provides some comfort to the shareholders to know that they have the right people in place to steer the corporation to realize its strategy, which in turn leads to an assured return on investment. Despite the elaborate and well-intended provisions of the *Mwongozo* and *CMA* Codes, this paper argues that the problem witnessed by most corporations can be traced to the appointment criteria. Initially, the failure of state-owned corporations was blamed on the fact that the appointment of board members was pegged on public officers who appointed their cronies as a way of returning favor due to being voted in power.[261] Interestingly, this status quo has not changed much even with the reforms undertaken in state corporations. In the case of *Benard Odero Okelo –vs- Cabinet Secretary for Industrialization Trade and Enterprise Development & 7 others,*[262] the Employment and Labour Relations Court nullified the appointments of members of the Business Premises Rent Tribunal on grounds that there was no competitive recruitment of the board members.

4.6. Board Systems And Procedures

The *Mwongozo* and the CMA Codes provide a structure in which the board should operate as well as the procedures to be followed so that the board remains effective while at the same time providing value

261. Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' (2007) 31(1) Fordham International Law Journal 34 <http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf> 34 accessed on 13th October, 2021.

262. [2020] eKLR.

addition to the corporation.[263] The codes guide the restructuring of the board into committees, which cover areas amongst others, audit, board nominations, risk management, remuneration, finance, investment and governance.[264] The board of directors have even been given a leeway to co-opt independent and external professionals to the committees to provide technical advice to the board.[265] The codes also require corporations to develop an annual board work-plan to guide its activities as well as the development of a board charter, which sets the roles, responsibilities, structures, process and authorities of the board.[266] The other important board procedure is the evaluation of the performance of board members annually.

The governance audit assesses whether the board committees are in place and how they discharge their mandate. It will examine the board evaluation tools and whether the process of evaluating the performance of board members achieves its objectives. Some of these objectives include: identifying strengths, skill gaps, and areas for improvement for board members to enhance their effectiveness. The results of the evaluation process should be discussed and areas for improvement for individual board members and the board itself agreed upon for implementation. The reappointment of board members for a subsequent term should be based on the results of the board evaluation exercise. Failure to establish proper

263. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 1 accessed on 5th January, 2023and Code of corporate governance practices for issuers of securities to the public 2015, Reg 2.2.1.

264. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 1.7 accessed on 5th January, 2023 and Code of corporate governance for issuers of securities to the public 2015, Reg 2.2.2.

265. Ibid.

266. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 1.9 accessed on 5th January, 2023and Code of corporate governance practices for issuers of securities to the public 2015, Reg 1.8.

board systems and procedures may impede the effectiveness of the board thus weakening the role of the board and exposing the corporation to risk.

4.7. Consistent Shareholder And Stakeholders' Value Enhancement

Mwongozo and CMA Codes do not directly speak on this governance parameter. However, this parameter entails deliberate steps by the corporation to ensure that there is capacity building among the shareholders and the stakeholders. It also involves the board taking necessary steps to enhance and promote the sustainability of the corporation. The governance audit assesses the policies and procedures as well as strategies put in place to promote the institutional and financial sustainability of the corporation. Some of the policies include a succession plan for senior management that ensures the corporation attracts and retains competent staff who will perform their duties effectively. There should be continuous innovation of the processes, products and services.

Failure to put in place mechanisms and strategies to promote sustainability may lead to loss of investors and public confidence in the operations of the corporation and exposure to reputational risks.

4.8. Corporate Social Responsibility (CSR) and Investment

Mwongozo and CMA Codes underscore the need for corporations to ensure that a policy on CSR and investment is in place.[267] *Mwongozo* goes further to obligate corporations to ensure that the policy on CSR and investment is implemented and that the corporation sets aside a sustainable and appropriate budget to fund the CSR activities which should include sustainable development.[268] *Mwongozo* and CMA Codes underscore the fact that a corporation should not only mind about its financial performance, but should also be alive to the impact of the corporation's operations on the society and environment.[269] This is because a corporation is a corporate citizen and being one, it should aim to protect, enhance and invest in the well-being of the society as well as the natural economy.

A governance audit checks whether the corporation has put in place a policy on CSR and investment as well as setting-aside monies towards implementation of the CSR policy. This will help minimize risk on the part of the corporation in that a corporation that engages in CSR as well as sustainable development is seen as a good corporate citizen and will gain legitimacy within the environment that it operates in. Most stakeholders would like to be associated with a corporation that has a good corporate image and as such, it would be important if they

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267. See Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 2.9 accessed on 5th January, 2023 Mwongozo' (State Corporations Advisory Committee, 2015) <*https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf*> accessed on 5th January, 2023and Code of corporate governance practices for issuers of securities to the public 2015, Reg 7.1(i).

268. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> para 4.5 accessed on 5th January, 2023.

269. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 4 accessed on 5th January, 2023.and Code of corporate governance practices for issuers of securities to the public 2015, Reg 5.

are aware of the activities that a corporation engages in. Corporations can, therefore, capitalize on investing in elaborate CSR engagement as a way of strategically marketing themselves and their products thereby increasing their sales.[270]

An audit of the CSR programs is also important because it assists the directors of the corporation to give proper and accurate accountability to the shareholders at a shareholders' meeting that the monies allocated for CSR and investment is used in a prudent and efficient manner and in line with the CSR policy. This will help the corporations manage the expectations of the shareholders and avert the risk attendant to shareholders conflicts because in most cases, the money set aside for conducting CSR is from the profits of the corporation, which in essence would be dividends that accrue to shareholders. Corporations have also been faulted for undertaking CSR activities as a marketing gimmick. Most corporations also have CSR policies on paper and for ensuring compliance with the law but in real sense, their CSR initiatives are not guided by the policy. The audit also enables the corporation to evaluate the impact of the CSR programs on the community and establish whether the desired objectives were achieved.

A corporation that lacks a CSR policy may not be able to engage in a well-structured and meaningful CSR projects and this may impair their reputation and image. In addition, the corporation that does not evaluate the impact of its CSR projects on the community may not be able to measure the impact of their initiatives undertaken to establish their true value.

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270. Inna Khovrak, 'CSR as an effective tool of strategic management' <https://www.researchgate.net/publication/339079990_CSR_as_an_effective_tool_of_strategic_management/link/5e3c6032458515072d861564/download> 83 accessed on 2nd November, 2021.

5. Challenges Around Governance Audit Exercise

Several challenges affect the process of undertaking the governance audit and implementing the governance audit reports.

There is a slow or even lack of implementation of the governance audit report by the corporation. Once a governance auditor has completed his/her work, he/she is required to present a governance audit report to the board.[271] The governance audit report among other things should contain the opinions of the governance auditor, which are either positive or negative.[272]The board is obligated to report the findings of the governance auditor in its annual report to the shareholders disclosing in full any qualification or observation or other remarks contained in the governance audit report.[273] In most cases, the board will be hesitant to make this disclosure, adopt a selective implementation of the report, or not adopt the report in totality. The non-adoption or selective adoption of the governance audit report may be detrimental to a corporation for the reason that a governance audit report contains key audit findings and recommendations that are meant to ensure the corporation is operating on sound CG principles and practices as well as acting as a risk management tool. Ignoring the same may be very catastrophic to the corporation. Similarly, the conduct of a governance audit entails the payment of professional fees to the governance auditor.[274] It would therefore cost the corporation money for a document that is shelved.

A corporation is also required to give full assistance and support to the governance auditor to enable him/her to carry out the audit activities.[275] This assistance includes access to the corporations' policies and documentation that are necessary for the governance auditor to conduct

271. The Institute of Certified Public Secretaries of Kenya Governance Audit Guidelines GG 003, Reg 16.0.
272. Ibid, Reg 16.3.
273. Ibid, Reg 16.5.
274. Ibid, Reg 13.0.
275. Ibid, Reg 19.

the audit exercise.[276] Corporations are also mandated to provide the governance auditor with the necessary facilities including working space to use in reviewing documents. The governance audit may also request meetings with the board members and senior management to discuss their views and experiences at the board and operations of the board. The provision of the requested documentation and sparing time to meet the governance auditor is solely at the discretion of the corporation. Therefore, where there is non-disclosure or selective disclosure of information coupled with not according to the governance auditor maximum support, may compromise on the output of the audit.

In some cases, corporations do not set aside an appropriate budget for the governance audit exercise. This, therefore, means that the audit undertaken is not robust to encompass all the parameters that are required. Similarly, it may also inform on the competence and experience of the governance auditor that they engage for the reason that they are either saving on cost or do not have money at all. This may affect the quality of the report produced for implementation.

In addition, the number of accredited governance auditors are few.[277] *Mwongozo* and the CMA Codes require that a competent and recognized professional accredited by ICS should conduct a governance audit.[278] It is, therefore, apparent that there is a gap and most of the governance auditors may be overwhelmed with the number of assignments to be undertaken. Similarly, corporations may not have the luxury of selecting a governance auditor of their choice because of limited options.

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276. Ibid, Reg 8.

277. A look at the ICPSK website shows a list of 260 registered governance auditors <https://www.ics.ke/cs-directory-1?view=directory&auditor=on&submit=Search&start=240> accessed on 2nd September, 2021.

278. Public Service Commission & State Corporations Advisory Committee 'Mwongozo: The Code of Governance for state Corporations' (2015) <https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf> Reg 1.13 accessed on 5th January, 2023and Code of corporate governance practices for issuers of securities to the public 2015, Reg 2.11.1.

The *Mwongozo* and CMA Codes require that a governance audit be conducted at least annually.[279] Indeed, the issue of the frequency, cycle, cost as well as scope of the governance audit has been of great concern to the stakeholders.[280] The stakeholders believe that conducting the same annually is too frequent and as such, it is expensive to the corporation. After considering views from stakeholders, the CMA recommended that the CMA code be amended to have the governance audit conducted at least once every 2 years.[281] The CMA was also considering adopting a risk-based approach to the conduct of a governance audit by corporations. This approach would entail an assessment of a corporation's performance on the conduct and implementation of the report. A corporation would be entitled to a two year cycle of governance audit where it demonstrates that it has conducted at least one governance audit and the corporation is proactively implementing the findings of the audit.[282] Despite this observance, the CMA Code has not been reviewed and corporations are still required to conduct governance audits at least annually. *Mwongozo* Code still requires state corporations to undertake governance audits annually.

The requirement to conduct a governance audit by corporations is not mandatory and as such, its enforceability is not binding on corporations.[283] This is because the *Mwongozo* and CMA codes take the form of soft law regulations, which are not binding. Compliance with the codes takes the form of a "comply or explain approach" where corporations are at liberty to comply with the codes or explain non-compliance. This, therefore,

279. Ibid.

280. Capital Markets Authority, '*Governance Audit*s' (Circular No. 1 of 2020) <https://www.cma.or.ke/index.php?option=com_phocadownload&view=category&download=533:governance-audits&id=92:corporate-governance-for-issuers&Itemid=285> 1 accessed on 2nd September, 2021.

281. Ibid.

282. Ibid. See also Patrick Alushula, *'CMA mulls reduced audits for firms with strong scores'* Business Daily (Nairobi 15th March 2020) <https://www.businessdailyafrica.com/bd/corporate/companies/cma-mulls-reduced-audits-for-firms-with-strong-scores-2283818> accessed on 2nd September, 2021.

283. Nojeem A. Amodu, *Corporate Social Responsibility and Law in Africa: Theories, Issues and Practices* (2020, Routledge) 3-85.

means that corporations are at liberty to decide whether or not to conduct a governance audit especially those that are not regulated by the CMA and *Mwongozo* Codes. Even though the non-binding nature of the codes is lauded as promoting best practices, the option of not conducting a governance audit creates a loophole that exposes corporations to risk.

6. Conclusion

The paper has explained the importance of undertaking a governance audit as a risk management tool within the parameters provided for by the *Mwongozo* and CMA Codes. It has established that the parameters provided by these Codes for the conduct of a governance audit are sufficient. However, the governance audit exercise will only benefit the corporations if it is undertaken periodically and the governance audit reports implemented fully and promptly.

Conducting a governance audit helps corporations to minimize unnecessary costs that would accrue from exposure created by the failure to address any gaps and weaknesses in the governance structures and systems through an audit exercise. Secondly, the image and reputation of the corporation are critical to the business because most stakeholders often associate themselves with corporations that observe laws and respect stakeholders. Thirdly, investors invest in corporations that engage in sound CG, as this guarantees them a return on their investment. It is, therefore, necessary for corporations to conduct an in-depth and independent audit to win investor confidence. The conduct of a governance audit will also protect the corporation from the risks attendant to defending the corporation in litigations, which would be costly. Fourthly, the conduct of governance audit ensures the sustainability of the corporations for the reason that it operates and acts as a health check. Corporations can assess whether they are fit to conduct business as well as compete in the market.

The paper has also highlighted the need for having a more robust, clear and elaborate enforcement mechanism on corporations that do not comply with the requirement to conduct a governance audit periodically. Save for the CMA Code that imposes drastic measures of delisting corporations that do not comply with the Code, the *Mwongozo* Code does not give a clear framework on the sanctions that are to be imposed on corporations that are non-compliant. It would therefore be recommended that *Mwongozo* provides a clear sanction on failure by the corporations to undertake a governance audit. Thus, the paper proposes the need to streamline the laws and guidelines relating to regulation as well as observance of the governance audit process.

As discussed above, there is duplicity and overlap of the laws, which encourages corporations to engage in a box-ticking exercise of governance audit. The paper recommends that the requirement for undertaking governance audits should reduce the frequency of the audit exercise to make it a more valuable, robust and effective tool for managing risks. The laws should be properly aligned to check against the overlap and box-ticking.

Corporations should endeavor to develop a clear implementation plan for governance audit reports to make the audit findings and recommendations beneficial to them. For the report to add value to the improvement of the governance structures and systems, the implementation plan should contain clear mechanisms for timely tracking and follow-ups of the audit recommendations and reporting lines to ensure all the gaps identified are closed before the next audit is undertaken. Failure to implement previous governance audit findings and recommendations will also impair the importance attached by staff, management and the board on the governance audit exercise and will result in instances of non-compliance with sound corporate governance practices. Besides, since the governance audit exercise cost money, the board should ensure it derives the greatest possible benefit from the audit exercise. This can be achieved by ensuring timely implementation of all the audit recommendations agreed upon.

The corporations should develop and implement internal procedures that require employees and board members to support audit exercise through timely production of documents, provision of support and availability for audit interviews. This will enable the governance auditor to complete the exercise within the stipulated timelines and submit a quality report to the board for implementation

The corporations should also allocate enough funds in their annual budget for the governance audit exercise. This will ensure that a robust and in-depth governance audit is undertaken for the benefit of the corporation.