



**REPUBLIC OF KENYA**

**IN THE HIGH COURT OF KENYA AT NAIVASHA**

**CORAM: HON. R. MWONGO, J**

**CIVIL CASE NO. 2 OF 2014**

**BT LIMITED.....PLAINTIFF**

**-VERSUS-**

**MNN.....DEFENDANT**

**JUDGMENT**

**Background**

1. The Plaintiff is a private limited liability company. Its directors are the Defendant who was its Operations Director, and her husband DN, as Sales and Marketing Director. From the company's Memorandum and Articles of Association the couple are also the sole shareholders, each holding one share.

2. The couple formed the business in June, 1994, and worked together on the basis of their personal relationship. They fell out due to marital differences in August 2011, and separated. The defendant ceased working as the Operations Director of the plaintiff, left Naivasha, and settled in Mombasa. There, she opened a similar business.

3. According to the plaint filed on 12<sup>th</sup> August, 2014, the defendant embezzled the company's funds. Her husband and co-director caused an audit to be conducted on the company's books to establish the extent of the problem. As a result of the audit, the plaintiff seeks judgment for:

- a) The sum of Kshs 25,166,865.01
- b) General damages
- c) Interest on (a) and (b) at commercial rates
- d) Costs of the suit

By consent, the suit was filed as a derivative suit.

4. It is noted that the Defendant had on 20<sup>th</sup> February, 2014 filed a petition for the winding up and distribution of assets of the plaintiff company in Winding-up Cause No. 1 of 2014 at Nakuru. The matter was transferred to this court which ordered the proceedings in that suit to be stayed pending the determination of the suit herein.

**The Hearing**

5. DN testified as PW1 on behalf of the Plaintiff. He adopted his written witness statement. He said the company carried out the business of [particulars withheld]. The defendant was the manager of the [particulars withheld] shop and he was responsible for the transport side. He noticed problems in the company in 2010 when there was neither stock in the shop nor money in the bank. The company had five accounts, shown in the Plaintiff's Bundle (PB) Pages 2 - 7.

6. PW1 put together two volumes of receipts and commissioned an audit of the Plaintiff Company's accounts by Njuguna Kioi & Associates Auditors. The audit covered the period 2009 - 2011 and, according to PW1, it disclosed that Kshs 25,166,865.10 was allegedly missing from the company. He thus got his lawyer Mathi & Company Advocates to write the defendant a demand letter. It is dated 24<sup>th</sup> July, 2014 and is annexed in the Plaintiff's Bundle Page 28. It demanded Kshs 22,801,625/= for misappropriation and Kshs 2,365,240.10 being illegal withdrawals from the company's accounts. He produced a Fraud Audit Report and bank statements and schedules showing the alleged

transactions.

7. PW1 stated that they used to buy stock for the shop by cheque. The Defendant would notify him to whom to write cheques and they would both sign as required by the bank mandate. According to him, no supplier was paid in cash and she had permission to withdraw money with his consent. After she moved to Mombasa he sought her out but she said she did not want to be involved in the company.

8. In lengthy cross-examination, PW1 testified as follows: That the defendant left their home and the company on 20<sup>th</sup> August, 2011; that the company continued in business; he remained the sole director; in his estimate the company was valued at Kshs 4,000,000/= in 2011; the transport department had a lorry and he was in charge of transport; Defendant was in charge of supplies; she would write cheques and notify him; In respect of transport he would make payments by cheque and notify her; Both of them could sign cheques.

9. He reiterated the company's five bank accounts; those that had cheque books were Barclays Bank Account No. [...], CFC Bank Account No. [...] (a loan/business account) and Equity Bank Account No. [...]. He kept the cheque counterfoils in the shop. Those without cheque books were Barclays Bank Account No. [...] (loan) and Barclays Bank Account No. [...] (loan).

10. He further testified in cross-examination that when he wrote cheques himself, he would collect the money from the bank. He confirmed that in his August 12<sup>th</sup> 2014 statement he averred that there could be no withdrawal without his consent. He said an auditor he called to check the accounts in 2010 with his wife, was chased away by her. After that there was suspicion between the two.

11. When instructing the auditor PW1 said he wrote them a letter - which was not produced with his list of documents. He admitted that daily transactions reconciliation was not done for the business; he said he did not have any VAT records, and that the Defendant left with some company records; that he continued running the company although Defendant left a debt of Kshs 10,500,000/= when she left the company; that the company still has the lorries; that the company has not since made profits; that he gave the auditor all the accounts of the company as shown from Plaintiff's Bundle at Page 28.

12. Finally in cross-examination he said that M used to take money from the company; that he did not pay her maintenance and that he went to Mombasa to urge her to return home and to the company, which she declined. She had since opened her own [particulars withheld] shop there.

13. In re-examination, PW1 stated that he is now the only functional director of the Company; that he cannot remove her as a director; that he is not very educated.

14. PW2 was CPA Sambu Chris who holds a Bachelor Degree from Kabarak University and was a qualified CPA holder. He testified that their firm, Njuguna Kioi & Associates was appointed to do a normal audit for August 2009 - 2011. He was given invoices, bank statement and other documents and prepared an Audit Report (shown as Plaintiff's Bundle Pages 32 to 52) in December 2011. He handed over the Report to PW1 who was dissatisfied because he expected the company to be doing better.

15. Accordingly, he said, PW1 asked him to do a Fraud Audit to find out why the company was doing badly. He went ahead and prepared a Fraud Audit Report shown at Page 53 to 75 Plaintiff Bundle which revealed discrepancies of Kshs 25,166,865.10. He was able to isolate the fraudulent discrepancies as follows:-

- a) Cash receipts vis a vis bankings - Kshs 22,801,265/=.
- b) Cheque withdrawal without explanation Kshs 1,585,000/= (Plaintiff's Bundle Page 67 - 75).
- c) Page 14 Plaintiff Bundle Bank transfers to Account and phone of Defendant.
  - Plaintiff's Bundle Page 16 Transfer to Account No. [...].
  - Plaintiff's Bundle Page 24 - 2 Transfers.
  - Plaintiff's Bundle Page 14, 16, 24 - Transfers totaling Kshs 783,600/=.

He also set out the stock amounts in 2008 - 2011.

16. In cross-examination, PW2 confirmed that the Audit firm he was employed in is licensed; that he is a member of the firm, and he has a CPA Number 15667. He said there was a scope of audit although it was not given in a letter. That PW1 visited their offices and thereafter asked the firm to provide the service, namely, a normal, not specific, audit; that the firm gave two previous audits prior to the Fraud Report.

17. He further stated that International Fraud Report Standards require the comparison of two years; That the Plaintiff's Bundle Page 36 gave the true state of affairs of the company with the Firm's opinion at Plaintiff's Bundle Page 46. He admitted that the client is supposed to sign to approve the audits.

18. When shown Plaintiff's Bundle Pages 14, 16, and 24 highlighted statement entries of 2013 and 2014 he said they were not covered in the Audit Report and are not part of a normal audit; that he did not get explanations on variations from the directors as the Defendant was unwilling though PW1 was willing; that there was a daily sales short fall of Kshs 28.8 million for 2009 - 2011.

19. Further, he stated that they reviewed three accounts, two Barclays and one Equity account which dealt with daily income, as the other two were for asset financing. As for suppliers, PW1 had told him they were paid by cheque and he perused the cheque counterfoils which were not produced in court; that there were no documents to show that the Defendant took cash to pay for supplies; that they did not make a comparison to see what cheques were paid to PW1 as that was not part of their mandate; that they were not given a specific brief to establish a case of fraud to fix the Defendant who had allegedly been forcefully thrown out; and that they have never been chased away from doing an audit of the company.

20. In re-examination PW2 stated that the engagement for the audit was between the firm and the company. He worked for the firm and was given the assignment by the Firm's Audit Manager; that it is not necessary or a requirement for a client to sign an audit report; that he did not reach out to the Defendant as he could only do so through the appointing authority who told them he had tried to reach her unsuccessfully; that the client accepted the audit report; that the two loan accounts were specifically for receiving loan repayments and finally that he was unable to find out how much was found to suppliers as it was impossible to reach the defendant.

21. The Defendant gave evidence as DW1 adopting her written witness statement and added some critical information in her evidence. She confirmed that she was a Co-director in the company with PW1; that the company acquired many properties and assets over time; that in 2011 she disagreed with PW1 as a result of which, she alleges, he chased her out of the business.

22. She asserted that the company had five vehicles including 2 large lorries and a pick-up used in the transport section. She handled the hardware shop, orders, banking and selling. She stated that the accounts they had were:

Family Bank - MN; KCB - DG and BT Limited had accounts at Barclays, Equity, Stanbic and Co-operative Bank; that all accounts were used in the business; that for BT Limited both directors could sign singly; For CFC Stanbic Bank two signatories were required.

23. She stated that they had stocks of over Kshs 100 million and sales were Kshs 200,000/= to 600,000/= per day. Stocks were purchased in cash and if sales were insufficient they would withdraw from the bank. Cash withdrawals given to PW1 were for him to go and buy supplies in Nairobi. Cheques would be signed by both directors and one would withdraw.

24. Further, she testified that audits were done annually, but when she was chased away in 2011 she ceased to be involved in the company, and that when she was in the company, there was no claim of missing money. She denied having taken any money from the company.

25. In cross-examination she re-confirmed that she left the company and went to Mpeketoni, Lamu in 2011; that her phone number was 0721 [...]. Shown Page 62 Plaintiff's Bundle she confirmed that Equity Account Number [...] was her account which had never been changed; that whenever they withdrew money from the company it was by agreement; that there was no branch in Mpeketoni.

26. She admitted that Equity Bank Account [...] belonged to the Company; she confirmed a withdrawal from Digo Road Branch on 9<sup>th</sup> November, 2012; she admitted the code for the post box in Mkowe Mombasa was [...]; that PW1 bought properties in his name for the company's money; that after leaving the company in 2011, she transacted in the company accounts; and that she needed to withdraw money for the children.

27. In re-examination, she asserted that there was no Equity Account at Mkowe, that she had never been involved in such an account; that any money she withdrew since 2011 was for school fees, hospital costs, food for the children who came to live with her after the separation. She denied the existence of the account in her name at Plaintiff Bundle page 62 and asserted that the only account in Equity was for the company.

### **Parties' Submissions**

28. The Plaintiff's submissions rehashed the evidence and submitted that there was proof that the defendant had in breach of a fiduciary duty, withdrawn money from the company's account and converted one of its accounts into her name; and that the audit had revealed a loss of Kshs 25,166,865.10. According to the Plaintiff, the audit report detected the total basis attributable to the defendant.

29. The defendant's case challenged the basis of the fraud audit; it contended that after the couple disagreed in August 2011, the defendant ceased to have anything to do with the company as PW1 had assumed full and exclusive control of the Company's business; that PW1 returned all records of the company; and that the Defendant admitted making some cash withdrawals after leaving the company, but that was a shareholder and director given that she had no immediate job.

30. The issues agreed by the parties for determination were:-

- a) Whether the defendant had a fiduciary duty to the company and her co-director to act with the highest degree of honesty loyalty and trust.
- b) Whether the defendant breached the duty by appropriating the company's funds to her own use.
- c) Whether the plaintiff is entitled to the reliefs sought.

### **Analysis and Determination**

31. From all the evidence availed, my general view of the running of the company is that: initially the company ran on trust with each co-director carrying on their aspect of the business. Like many husband and wife companies, the company had no formal operational systems

and policies in place; formal minutes and records of a statutory nature were hardly kept or relied upon; that once trust was broken it was open for any of the co-directors to run their side of the business without too much interaction with the other; the failure to file Annual General Meeting records and duly adopted Financial Statements and Accounts, suggests that these were not regularly prepared and maintained. This is the general backdrop upon which the company appears to have operated.

#### **Whether the defendant had a fiduciary duty to the company**

32. The defendant after citing Mason J in **Hospital Products Limited v United States Surgical Corporation (1984) 156 CLR 41** High Court of Australia, affirmed that the Defendant had a fiduciary duty to the company. The cited case defines a fiduciary as follows:

*“The word fiduciary refers to trust and confidence. A fiduciary is a person who acts for, or on behalf of, or in the interest of, another person in the exercise of power or discretion which will affect the interest of that person in a legal or practical sense.”*

#### **Whether the defendant breached the fiduciary duty**

33. The plaintiff relied on the Fraud Audit Report for August 2009 - August 2011 prepared by Njuguna Kioi Associates to prove fraud in respect of Kshs 22,801,265. The auditors testified that their firm was appointed to do a normal audit first. They did that and came up with financial reports and accounts for the years ended 31<sup>st</sup> December 2009, 2010 and 2011. The reports are at pages 32 to 52.

34. I have perused the said reports. They are “drafts” in that they are unsigned by the directors, and no minutes were availed confirming their approval by the company. The income statements for 2008, 2009, 2010 and 2011 show gross profits of shillings, 3,887,464, 4,048,499, 5,644,543 and 5,004,880 respectively. The administrative and operating expenses were high, eating into the profit in 2008 - 2011 as follows. 1,629,206; 1,888,237; 5,336,106 and 4,762,052 respectively. The profit after tax for each of those years is Shillings 145,132; 765,848, 441,306 and 537,654 respectively. In the accounts, the explanatory notes for the administrative and operating expenses were indicated at notes 6 and 7. All those figures reveal nothing unusual.

35. The Fraud Audit Report made three key findings:

a) That proper books of accounts were not kept.

b) That not all daily sales were banked: the variance in banking by comparing the Daily Sales Register and the Daily Bankings establish[ed] a difference of Kshs 22,801,265/= as per attached schedules.

c) The company’s name at Equity Bank was changed to read Mrs MNN from 20<sup>th</sup> February, 2010 to 31<sup>st</sup> March, 2010 and 1<sup>st</sup> May, 2010 to 30<sup>th</sup> June, 2010.

36. The failure to keep proper books of accounts cannot be attributed solely to the fault of the defendant. That is a matter which ought to have been handled through management letters after each year’s audit, and the directors should have resolved the same.

37. As for the failure in banking daily sales, the schedule annexed by the auditor covers three periods:-

a) August to December 2009 Turnover Sales of 19,850,516, and Total bank Deposits of 22,612,721 giving a positive variance of Kshs 2,762,205.

It is not clear why only a five (5) month period was used for the Fraud Report for year 2009 whilst the 2009 Financial Report and Accounts shows an annual turnover of Kshs 34,911,502. I do not consider this to be a comparison of *apples with apples*.

b) January to December 2010 Turnover Sales of 79,349,907 against Total Deposits of 52,177,129 giving a negative variance of a massive Kshs 27,172,799.

The Financial Report and Accounts for 2010 shows the turnover was Kshs 52,665,345 - higher than the Kshs 52,177,129/= in the Fraud Report by Kshs 488,216. This shows an error in the capturing of total sales.

Further, once the Fraud Audit disclosed the 2010 turnover to be 79,349,907, that is the figure that ought to have been indicated as the turnover in the 2010 Financial Report (instead of 52,665,345). From that figure, the costs of sales of Kshs 47,020,802 in the Financial Report would have been deducted to result in a Gross Profit of Kshs 32,329,105 (79,349,907 - 47,020,802 = 32,329,105/=).

As the 2010 Financial Report now stands, the Plaintiff company cannot properly and legitimately allege its turnover was Kshs 79,349,907 when that figure does not feature in the audited accounts. There must be consistency between the turnover figures in the Financial Report and those alleged in the Fraud Audit. The Company can only claim compensation refund of what its audited accounts shows is due to it.

c) January to August 2011 Turnover Sales of Kshs 45,704,434 against Total Deposits of 47,313,743 giving a positive variance of Kshs 1,609,309. As with the August to December 2009 computation, it is not clear why a seven (7) month period has been utilized for this computation whilst the audited Financial Report and Accounts for 2011 shows an annual turnover of Kshs 49,277,329.

38. The plaintiff through PW1 has relied on the audited Financial Report and Accounts for years 2008 to 2011, and admits them to be accurate. The auditor, PW2 has also asserted the veracity of the audited Financial Report and Accounts. As noted, these reports as presently framed, do not support the fraud claim based on the sales turnover and deposits. Further, there is an error in the capture of the 2010 turnover vis a vis the Fraud Report, and excess deposit in August to December 2009 and January to August 2011 or 4,371,614 (Kshs 2,752,205 + 1,609,309 = 4,371,515/=). All in all, I am not persuaded that the claim for Kshs 22,801,265 is properly supported, given the high threshold for proof of fraud discussed later.

39. With regard to the claim that the defendant changed the company's Equity Bank Account, my findings are as follows.

40. PW1 testified that the company had five accounts already highlighted herein. DW1 did not dispute the accounts cited by PW1. She added that the Company also had accounts with Stanbic Bank and Co-operative Bank but did not provide any evidence for those. She also stated that she had an account with Family Bank and DW1 had an account with Kenya Commercial Bank. For those, also, she provided no evidence.

41. In cross-examination (DW1), admitted as follows

***"I left Big two in 2011.....After I left it is true that I removed some money from the company account. We had an account at Equity Bank. I cannot remember the account number.***

Shown the Plaintiff's Bundle Page 62 which is an Equity Bank statement for herself as member MNN Account No. [...] she said:

***"This is my account with Equity Bank. It has not been changed."***

The statement of account is for 2010 and the account number is exactly similar to that of the Company's account.

42. DW1 also admitted that Equity Account No. [...] at Plaintiff's Bundle Page 88 belonged to the Company. The member name is BT Limited. She was shown Plaintiff's Bundle page 86, an Equity Bank Statement for the same Account Number [...] but with the Box number changed to Box [...] Mkowe Mombasa. She stated that:

***"The code for the Box is at Mkowe Mombasa. I would withdraw from Big Two Limited.....After 2011 I transacted in the Company Accounts. I needed to withdraw money for the children....."***

43. From the above evidence it appears that Equity Bank Account Number 0200 201 482 768 was shared by the following persons:

Mrs. MNN - Plaintiff's Bundle Page 62 in 2010.

BT Limited - Plaintiff's Bundle Page 86 in 2014

BT Limited - Plaintiff's Bundle Page 88 in 2012

The transactions in all three accounts reflect at least one common customer, namely, Bila Sahaka Flowers, which suggests to me that they are connected accounts.

44. From the foregoing, I am persuaded and do find that there was impropriety in the operation of the company Account Number [...] in the name of the defendant. I also find that the defendant was operating the said bank account both before and after her departure from the company in August 2011, which she admitted. It appears, therefore, that she was running a parallel banking enterprise: one in her name the other in the name of the company using the same account number. Strangely, Equity Bank appears to have permitted this situation by allowing the co-existence of two entities using one account number.

45. Accordingly, with respect to the schedule to the Fraud Audit Report at Plaintiff's Bundle Pages 58 - 64, the defendant must account to the plaintiff for the withdrawal of the amounts tabulated therein and amounting to Kshs 6,752,533/=. She owes a duty to the Company to so account.

46. The next issue is the allegation in the Fraud Audit Report of the unexplained withdrawal of Kshs 1,582,000 from the Company's Barclays Bank Account. The allegation is that the amounts were paid to the Defendant through cash cheques, whilst the company's policy was to pay suppliers by cheque.

47. In Paragraph 5 of the Plaintiff the plaintiff alleges embezzlement as follows:

***"5. Upon presentation of the auditor's report, the plaintiff realized that the Defendant had embezzled a sum of Kshs 24,383,265.10 and appropriated the sum to her own use without the consent, knowledge and/or authority of the plaintiff."***

48. The Fraud Audit Report at Plaintiff's Bundle Page 56 breaks down the figure of misappropriated money as follows:

- Misappropriation was.....Kshs 22,801,265.10

- Unexplained withdrawals from Barclays Bank....Kshs 1,582,000.00

Total.....Kshs 24,383,245.10

49. **Black’s Law Dictionary**, defines “*embezzlement*” as follows:

***“The fraudulent taking of personal property with which one has been entrusted especially as a fiduciary. The criminal intent for embezzlement-unlike larceny and false pretenses-arises after taking possession (not before or during the taking).”***

50. In **RG Patel v Lalij Makanji [1957] EA 314** at 317 the Court of Appeal for Eastern Africa held as follows on the burden of proof required to show fraud:

***“Allegations of fraud must be strictly proved although the standard of proof may not be so heavy as to require proof beyond reasonable doubt, something more than a mere balance of probabilities is required.”***

51. The evidence availed in the Fraud Audit Report by the auditors was (see Plaintiff’s Bundle Page 55 and Pages 65 to 75):

***“We have established that Kshs 1,582,000/= was paid to MNN through the attached cheques. The money cannot be accounted for since it was the company’s policy to pay all suppliers by cheques, and there is no record to show how the money was disbursed.”***

52. The cheques for Barclays Bank Account No. [...] of BT Limited are listed at Plaintiff’s Bundle Page 65 and eleven (11) cheques are attached at Pages 66 - 75. I have perused copies of the cheques. Each cheque is made out in the name of MNN as payee and signed and opened by her. The list is as follows:

Date of the Cheque	Cheque No.	Amount (Kshs)
04/04/2011	30	50,000.00
05/04/2011	75	150,000.00
07/04/2011	76	200,000.00
13/04/2011	77	300,000.00
14/01/2011	43	88,000.00
14/05/2011	101384	350,000.00
15/04/2011	53	100,000.00
16/02/2011	54	120,000.00
18/02/2011	55	150,000.00
19/03/2011	70	24,000.00
22/06/2011	101404	<u>50,000.00</u>
<b>GROSS TOTAL</b>		<b><u>1,582,000.00</u></b>

53. Other than making a general denial of any embezzlement or impropriety, the defendant did not respond to the allegations concerning these specific cheques. In her evidence she only stated:

***“We used to purchase stock in cash. The money from purchase came from sales. If the sales were insufficient, we would draw from the bank. If no money in the bank, we would issue post-dated cheques.”***

She also testified that:

***“My responsibilities were to order goods, to go to bank, selling. I used to give him money to buy hardware goods.”***

54. In light of the fact that the cheques were open and drawn in her name, and there is indication that they were banked, received, and stamped and paid out in the name of the signatory, there is no doubt whatsoever that the amounts were collected by the Defendant. As she did not explain the purpose of the said over the counter cheque withdrawals, she was duty bound to do. Having not done so, the said amounts are recoverable by the plaintiff.

55. Accordingly, there is substantive weighty evidence that the defendant having collected money represented in the cheques and having not explained the purpose to which it was put, should pay back the defendant company the said amount.

**Disposition and Reliefs available to the Plaintiff**

56. In light of the foregoing, I summarise my findings as follows relative to the issues for determination and the plaintiff's prayers:

a) The plaintiff did not prove the difference of Kshs 22,801,265/= in Total Sales to Total bankings. The claim for the said amount fails.

b) The plaintiff is, however, clearly entitled to an account from the defendant for the monies withdrawn by the plaintiff in the amount of Kshs 6,752,533/= from the Company's Account Number 0200 201 482 768.

c) The defendant shall reimburse to the plaintiff the unexplained withdrawals from Barclays Bank Account Number [...] of the amount of Kshs 1,582,000/=. The same shall be reimbursed with interest at the prevailing Central Bank Commercial deposit rates with effect from 22<sup>nd</sup> November, 2011 when the last cheque withdrawal was encashed.

57. No case was made out for general damages, and the claim thereof is dismissed.

58. The defendant shall pay the costs of the suit

**Administrative directions**

59. Due to the current inhibitions on movement nationally, and in keeping with social distancing requirements decreed by the state due to the Corona-virus pandemic, this Judgment has been rendered through Teams tele-conference with the consent of the parties noted hereunder, who were also able to participate in the conference. Accordingly, a signed copy of this judgment shall be scanned and availed to the parties and relevant authorities as evidence of the delivery thereof, with the High Court seal duly affixed thereon by the Executive Officer, Naivasha.

60. A printout of the parties' written consent to the delivery of this judgment shall be retained as part of the record of the Court.

61. Orders accordingly.

**Dated and Delivered in Naivasha by teleconference this 3<sup>rd</sup> Day of December, 2020.**

.....

**R. MWONGO**

**JUDGE**

Attendance list at video/teleconference:

1. Ndung'u holding brief for Mathi for the Plaintiff
2. Akang'o for the Defendant
3. Court Clerk - Quinter Ogutu