A RELATIONAL ANALYSIS OF CORPORATE GOVERNANCE

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One of the realities brought forward by the financial crisis is that the corporate Governance, based until now mainly on self-regulation, has not been as effective as possible. A better management of organizations is important not only in order to reduce the possibility of occurrence of a new crisis in the future, but also for organizations to be more competitive. Currently we do not have a definition of corporate governance that is unanimously accepted. At global level, there are a variety of definitions for this term, depending on national, cultural or legislative characteristics. In this article we present the concept of corporate governance as being a complex process occurring at the level of the management of the organization, which integrates control, risk management and internal audit in a formula that is meant to determine the level of performance for the organizational achievements.

Key words: *governance; corporate governance; best practices; management; internal audit; risk management; internal control.*

1. CORPORATE GOVERNANCE: CONCEPTUAL DELIMITATIONS

The term "governance" is a general concept that is associated with contemporary social sciences, especially economy (corporate governance) and social policies (public governance) with reference to the economic and political behavior of organizations in relation with the decision making, executive and legal process [11], [19].

The concept of corporate governance emerged and developed during the last century and it was influenced in turn by economic environments based on family property, bank capital, institutional investors or anonymous societies, environments which were stirred by the great scandals that happened in time [10], [20].

In our days, the concept of corporate governance is related with the process of adaptation to the modern economy requirements, to the more obvious globalization of social life and at the same time to the necessity to inform investors and the third parties interested in the activity of companies [14].

Initially, the term "governance" was used in the management of colonial territories, being gradually adopted by the management of national institutions (e.g., banks), but also of public and commercial organizations.

Later on, the term "corporate governance" was adopted, being first applied to organizations with commercial activities, and it gradually made its way to the public sector. The management on the basis of those principles can bring more value with regard to the interests of the tax payers and of the general public, who have the right to know that the public institutions are well managed in their activity of offering public services financed by public funds [11].

In order to conceptually understand the notion of corporate governance, we continue by emphasizing a number of relevant definitions. Thus, corporate governance represents [11]:

• "The system through which the companies are managed and checked" (Adrian Cadbury, 1992).

• "The ways through which we equally make sure that long term objectives and strategic plans are set, but also that the management and management structures adequate to reaching these objectives exist, making sure at the same time that the structure functions with the purpose to maintain the integrity, reputation and accountability of the organizations in front of its main electors" (National Association of Corporate Managers, USA).

•"... a combination of processes and structures implemented by the council in order to inform, manage, guide and monitor the activities of the organization with the purpose to reach its objectives" (the Institute of Internal Auditors).

The purpose of corporate governance is depicted in Figure 1.

Figure 1. The purpose of corporate governance [8]

The concept of corporate governance (referred in the International Standards of internal audit) emphasizes the management of the entire organization as a whole by accepting all its internal components, which function together, but which in the end will be integrated in the management through the implementation of the risk management within the organization, as well as of the financial management and the internal control, including the internal audit [6; 22]. Thus, it results that the internal auditor helps an organization reach its objectives by making systematic and methodical recommendations in relation with the evaluation and improvement of risk management, control and governance processes efficiency.

The notion of "corporate" refers to the "entire organization," taking into consideration all its internal components, integrated in a single structure; the notion of "governance" emphasizes a process within the organization that assures its guidance and control. Consequently, by logically adding those two words, it results the phrase "Corporate Governance" [11].

At the same time, the current practical tendencies envisage the management of the organization according to the principles of corporate governance. To this end, the concept requires a solid and efficient supervision of the way in which it is carried out, led, controlled and managed in order to protect the functions of the organization / institution [10].

At national level, the concept of governance is defined as being the "Ensemble of processes and structures implemented by the management with the purpose to inform, guide, manage and monitor the activities of the public entity toward reaching its objectives" [1].

At European Union's level, in order to strengthen and develop the applicability of Corporate governance, the EU Commission launched two guides in this field, referring to the rights of the investors. They were elaborated within the Action Plan adopted in December 2012 regarding the European legislation that refers to companies - European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies [21].

The notion of "Corporate Governance of public enterprises" is defined in another regulation that has recently come into force in our country, as the "Ensemble of rules that governs the system of management and control within such a public entity that manufactures goods or offers services, the relations between the superior public authority and the components of the public enterprise, between the management and supervision board, managers, stakeholders and other persons interested" [3].

The legislative framework that guarantees the objectivity and transparency in the selection of the management and of the members of the management bodies is the Emergency ordinance of the Government no. 109/2011 (with later modifications) regarding the corporate governance of public enterprises [2], [3]. The provisions of this emergency ordinance apply to the autonomous enterprises established by the state or by a territorial unit, to national companies, to companies in which the state or a territorial unit is the only stockholder, the major stockholder or which they control, as well as to limited companies in which one or more of the public enterprises already mentioned above hold a major participation or a participation that provides control over them [14].

According to expert opinions, the state in its stockholder position must put in practice the principles of Corporate Governance by acting as an informed and active partner, on the basis of a consistent, coherent and coordinated ownership policy, assuring the management of public enterprises in a transparent, accountable, highly professional and efficient manner [23].

In many states belonging to the Organisation for Economic Co-operation and Development (OECD), the public enterprises provide a consistent part of the Gross domestic product (GDP), occupation of the labor forces and market capitalization. These are sometimes predominant in sectors like infrastructure and utilities (e.g., energy, transport, telecommunications), and a large segment of the population, as well as other sectors of the economy, depend on their performance [10; 23].

It thus results that the state can benefit from the instruments applicable to the private sector (including the OECD principles regarding the Corporate Governance) in order to make its activity more efficient, gain profit and reach its objectives, including those of public policy, if it is the case.

Corporate governance is the combination of the control elements which operate together in order to regulate the relations between all those that have an interest in the company: stockholders, management, employees, clients, suppliers etc [20]. The main domains integrated within the concept of Corporate Governance are presented in Figure 2.

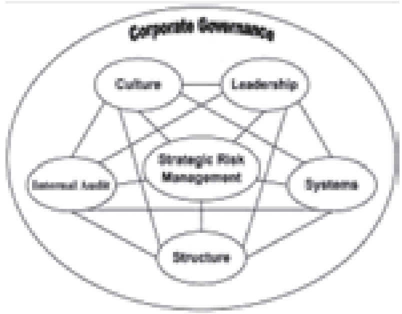

Figure 2. The main relational domains of Corporate Governance [24]

Consequently, Governance represents the "system through which organizations are managed and checked" or the "combination of process and structures implemented by the management in order to inform, manage, guide and monitor the activities of the organization in order to reach its objectives" [11].

One of the specific provisions of the concept is the necessity to separate the administration board from the management of the company. The administration board must supervise the activity of the management and make sure that it correctly reports to the shareholders [9; 25].

The interest manifested lately all over the world for governance offers it a large connotation which includes: ethic principles, social responsibility, good practice, and control activities.

There are two main issues regarding

the improvement of governance, with to usually refer: profoundly unethical corrupt and fraudulent behaviour practices by those who are at the top of the organization; the members of the low strategic (corporate) level of the management board (or of the top management) fail to provide the right direction for the organization or do not have the mechanisms to identify the significant problems or weak performance and fail to take the measures that are necessary for improvement [8].

Although the efforts necessary to obtain better governance began in the private sector, the principles equally apply to the public sector as well. It is thus understood that this concept can bring more value where the interests of the tax payers and of the general public are at stake, which have the interest that the public institutions be well managed in providing their specific services [10].

Figure 3 depicted the conditionings and interdependencies implied by the corporate governance which refer to: leadership and values, behaviour in business / ethics, competitiveness, social corporate responsibilities.

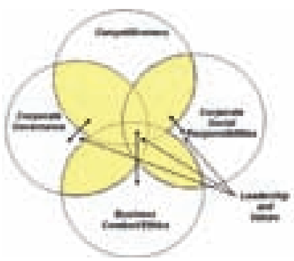

Figure 3. Determinations of Corporate Governance [16]

2. THE NEED FOR GOVERNANCE. RELATIONAL ELEMENTS. DETERMINING FACTORS OF CORPORATE GOVERNANCE

The need for governance is given by the separation that exists between those who manage the organizations and those who hold an interest in the organization.

In this respect, from a conceptual and relational perspective, corporate governance includes: ethical principles, social responsibility, good business practices and control activities. It thus results the appropriate association and integration within the governance of operational terms like internal audit, internal control external audit, and risk management. There is a complex and continuous relation between corporate governance, internal audit and management, as well as between corporate governance and management structures, but at the same time there is a special treatment that envisages the important aspects related to social responsibility and the ethics of practices in business [13], [15].

The public and private management has the obligation to apply the provisions of the specific corporate governance in a correct and qualified manner so that to objectively protect the interests of the factors concerned with the organization. Those factors could be internal or external and may have different requirements and expectations, sometimes even conflicting with those of the organization. They may also put pressure on the organization with the purpose of satisfying their own interests.

According to the theory and practice in the field, corporate governance includes the following managerial obligations: the managers' responsibility for the accuracy of information in financial reports; the existence of tight deadlines for financial reporting; communication and total transparency with regard to financial results; transparency of internal audit, processes and external audit. Without the association of these elements, the credibility of commercial/ private and public entities could be doubtful, because the financial results could cause suspicions regarding their conformity with reality [15].

Regardless of the fields in which they apply, the determining factors of the corporate governance are: integrity, transparency, responsibility, and competence [7].

Integrity represents a key concept that describes an appropriate and ethical behavior, the concern for the interests of others and social responsibility.

Transparency. Bad things or weak performance often occur behind closed doors. When things are open to public scrutiny or are subjected to justified challenges by competent persons, they have the tendency to improve. But the natural tendency of people is to avoid a thorough examination of what they do. Subjecting their own actions, decisions and performances to examinations leads to improved performances. Without transparency the organization can not learn to become better, it may in the best case scenario hide its weak performances for a while, which will only act against its interests.

Responsibility is the most important aspect of governance, and perhaps the least understood and definitely the rarest in organizations. If in an organization responsibility is not clear and well defined, both the staff and the management have full liberty to act as they will. The specialists define five essential steps in assuming responsibility which, if not taken fully, lead to serious problems that will affect the organization.

The steps mentioned mainly envisage [10], [21]:

• Clarity of roles and responsibilities - If people do not know very well their responsibilities regarding their activity, results and behaviors, how can we expect them to act in this sense?

• Necessity to be accountable to the person who assigned a certain responsibility regarding the way in which it was carried out - We refer to hierarchical reporting and accounting that starts from inferior levels and ends at the level of the management council.

• The persons you are accountable to must hold sufficient and concrete information in order to question your statements.

• The way in which responsibility is engaged must be open to independent examination.

• The existence of well intended mechanisms of reward and sanction, and this should function correctly and permanently.

Competence. It refers to the technical and behavioral abilities necessary to carry out responsibilities. The level of competence that is necessary to each position must be identified before that position is filled and must be revised regularly and the deficiencies corrected through development and specific measures [8].

In conclusion, integrity, transparency and responsibility hold no values if people do not also have the fundamental competences necessary to them in carrying out their activity.

3. CORRELATION OF ELEMENTS WITHIN CORPORATE GOVERNANCE

In order to ensure control mechanisms over managers in public entities that possess decision making autonomy (the right to use the resources allocated to them in order to achieve objectives), they are obliged by law [7] to implement adequate and functional processes of internal audit, risk management and internal / managerial control as major components of corporate governance. These three processes provide a systematic approach for the application of basic management rules in exerting the act of management that will increase the probability to achieve objectives in a legal, economical and efficient manner.

Within an organization (private company or public institution) the management represents the decision making factor in applying the principles of corporate governance. In this respect, the management team must clearly and precisely set the general objectives that the organization must attain, as well as the objectives partially subscribed to each subsystem within it. The objectives being mentioned are determined by the existence of that specific company itself, translated in specific programmes and strategies.

We can observe in this context that risk management, internal control and internal audit become major components of corporate governance which we will be addressed in a correlative manner further on.

Good corporate governance is dependent on risk management in order to understand the problems that the organization is confronted with and on internal control which allows measures that will ensure the attainment of its objectives to be taken [8], [25].

Risk represents the uncertainty related to the occurrence of an event which, when it occurs, affects the accomplishment of the objectives of the organization, while in some situations it may decisively contribute to its fizzle out. Consequently, risk is not something certain, but it is tightly linked to the objectives of the organization which it can negatively influence.

The implementation and functioning of a risk management process at the organizational level implies the adoption of a new type of organization risk. It requires the increase of the probability to achieve the objectives, through the existence of a reaction capacity when facing the consequences of the risks practical occurrence.

Usually, in an organization each activity is subject to one or more risks, and it is necessary that these risks be evaluated in order to establish their importance, according to which the responsibility in taking adequate decisions as a response to those risks is determined.

After the identification, evaluation and classification of risks, they must be managed in order to identify within the organization the potential events that can affect the attainment of the objectives, the management acquiring thus a permanent instrument that facilitates the management process.

In order to manage the risks, the management uses levers at its disposal in order to identify and evaluate them. At the same time, the management of the organization acts with the available resources and means in order to reduce the effects that risks may have on the attainment of objectives.

In these conditions, at the level of the management occurs the necessity to design an adequate strategy to manage the risks associated with all the objectives of the organization, as well as to design an adequate control system meant to ensure a permanent monitoring of threats (risks) [12], [13].

The economic crises that occurred in the US and European economies emphasized the fact that the accounting frauds are largely attributed to the lack of control. Thus, the close links between frauds, corporate governance and the role of control are highlighted. In this context, the informational transparency represents the indispensable element for financial market competitiveness, which leads to an efficient functioning of the systems of corporate governance and especially of control systems [15].

The management is responsible for organizing an adequate control system which, at the moment when it begins to function, has the role to maintain risks at an acceptable level for the leadership of the organization. The leadership must establish the general framework, including the strategy, policies and control responsibilities, on the basis of which it is necessary to conceive concrete ways of implementation, monitoring and reporting, followed by a periodic revision of the control system.

It results from the practice of economy that, through the existence of an efficient system of internal / managerial control, the leadership of every organization ensures an adequate control over the activities carried out by the management and execution personnel at different hierarchical levels and implicitly over the attainment of the proposed objectives. The implementation of an adequate system of internal / managerial control implies the alignment to the standards set by the Code of internal / managerial control [7; 15].

The control mechanisms /

instruments are necessary at all the levels and in all the positions within the organization and require two elements: a policy that clearly foresees what must be done, and procedures to put into practice the respective policy.

Through a systemic approach to the organization, the internal audit evaluates its capacity to attain its own objectives and to contribute to fulfilling the requirements of the society by monitoring the performance of the internal control and implicitly of the risk management.

The preventive role of internal audit within organizations is well known, keeping in mind that any type of governance, in order to be considered efficient, must envisage adequate control mechanisms and viable procedures of risk management, that will allow for intervention in critical situations in order to protect the actions of all the factors involved in the functioning of the organization [15].

Setting off from this fact, the identification of a vulnerable point or of a deficiency in the system will make the audit incapable of offering total insurance which, by means of recommendations, will draw the attention of the leadership on the problems that endanger the attainment of the objectives. Such a logical approach implies that, if the management personnel implement the recommendations of the auditors, they will receive assurances regarding the objectives' attainment [14].

By executing an audit of the system, the auditors focus their attention on the risks that may affect the fulfillment of the objectives and the way in which these risks are managed, as well as on the existing controls within the organization.

Thus, the internal audit evaluates the application of the governance in the systems of an organization, offering assurance and counseling to the leadership through recommendations regarding the introduction or improvement of policies, mechanisms and procedures.

4. CONCLUSIONS

From a conceptual and legal point of view, corporate governance emerged in Romania at the beginning of 2000. The first code of corporate governance was adopted in 2001. In 2008 it was replaced with a new code of corporate governance, which is based on the principles of the OCDE.

The concept of corporate governance continues to favoring a process of adaptation to the modern economy's requirements, to the more and more obvious globalization of social life and also to the necessities to inform investors and interested third parties in the activity of the companies.

The conclusions of the experts of the European Commission regarding the application of a new type of management at the level of public entities in Romania recommend attention especially towards increasing the managerial responsibility in the public sector and the administrative capacity to implement management systems in accordance with the principles of good practice accepted at international level.

Currently, the application of the "best practices" of governance in the developed economies determined the implementation of a new code of ethics in approximately 73% of European companies, while in Romania only 47% of companies declare information regarding the existence of such a code.

A good governance within the organization diminishes the risks, increases performance, opens the way toward financial markets, brings competitive goods and services to the market, improves the management style, shows transparency to all interested parties and social responsibilities. The lack of compulsory rules and structures can lead to chaos in business.

In the end it results that corporate governance integrates within any organization three fundamental elements: risk management, internal control system, and internal audit - as a key to monitor them. Thus, by blending these elements, the goal to optimize corporate governance, having as key factor the internal audit, is achieved.

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