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Corporate Governance – A Key Element of the Entity

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The present economic crisis has shown that the failure of ethical norms leads to the spread of negative effects globally. This propagation is performed according to the degree of dependence of the states with global economy. Certainly this event, which is considered to be normal in a market economy, highlights the threats facing any economic activity at any level of aggregation. Conducting corporate governance processes within the entities represents a new direction related to the correct development of the economic activities, the effectiveness of managerial decisions in order to reduce the threats generated by the current economic context.

Keywords: *threat; entity; corporate governance; internal audit*

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Introduction

The business environment has undergone a rapid and revolutionary change with consequences reaching organizations worldwide. In the last

half of the century due to the increasing trade and investment flows we increasingly talk of globalization.
Management responses to global competition have included quality improvement, initiatives to handle threats, reorganization of structures and processes, and greater accountability.
In such a climate, it is no surprise that the internal audit function in corporate governance process supports management decisions to adapt organizations to the current economic context. Moreover, corporate governance aligns all parties' interests, the intended objective representing the good functioning of the entity.

The Importance of Corporate Governance within the Entities

The term corporate governance, recently emerged in the literature, is presented as the cornerstone of the overall management of an entity. Sir Adrian Cadbury, considered one of the pioneers in introducing this concept, mentioned in the Report of the Committee on the Financial Aspects of Corporate Governance that corporate governance as "the system by which companies are directed and controlled". A similar approach is the one proposed by the Institute of Internal Auditors which defines governance as "a combination of processes and structures implemented by the board of directors to inform, lead, direct and monitor activities of the organization in order to achieve objectives."

Another definition is the one published by the International Federation of Accountants: "corporate governance is a set of practices of the board of administration and executive management exercised to ensure strategic directions for action, achieve goals, risk management and responsible use of financial resources".

According to the Organization for Economic Cooperation and Development, the structural elements characteristic to corporate governance are:

- "a set of relationships between the company's management, the board of administration, shareholders and other interest groups in the company;
- the structure through which the company objectives are set, the means used to achieve these objectives, namely to monitor performance;
- the system of incentives offered to the board of administration and to the managers to develop objectives meant to improve the company's business activity and the shareholders' benefits and to facilitate the monitoring, encouraging companies to use resources in a more efficient manner."

Corporate governance actually refers to the way of distributing rights and obligations between the different categories of participants in the company's activity, to the way of adopting decisions and formulating strategic objectives and strategies, the means by which this is achieved and the system of financial monitoring.

Beneficiaries of corporate governance Interested parties Investors Banks Suppliers Citizens Founders Public

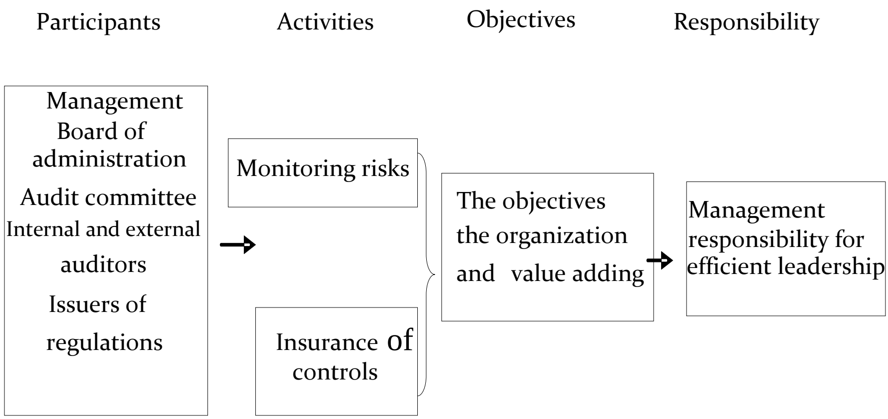

Figure 1: Characteristics of corporate governance

Source: adaptation after Dana R. Hermanson, Larry E. Rittenberg (2003), Professional Practices Framework for Internal Auditing. Internal Audit and Organizational Governance, the Institute of Internal Auditors, Research Foundation, p. 29.

According to the specialized studies, two main models of corporate governance have been identified:

- corporate governance oriented to the shareholders, which aims at optimizing shareholders and managers' decisions;
- corporate governance oriented to stakeholders, which does not only seek to maximize the shareholders' wealth, but also to protect the interests of all parties involved in the entity's activity (employees, partners, shareholders, managers, etc.).

Regardless of the adopted model, corporate governance should be guided by a set of well-defined principles, available internationally, which should not impose restrictions and must not excessively focus on the need for timely implementation within the national legislation.

The main objective of such principles is to provide a reference system, aiming to identify the goals and the means for implementing them.

Entities must continuously improve their corporate governance policies and constantly adapt to the changes that occur as a result of the innovation. This confers corporate governance some evolutionary principles, requiring the need to analyze and revise them in accordance with the evolution of the global business environment.

The principles of corporate governance formulated by the OECD deal with six aspects:

1. Ensure the fundamental framework of corporate governance by promoting the principles of transparency and efficiency of markets, harmonized with the legal and clear formulation of the principle of separation of responsibilities between supervisors, normalization authorities and implementation ones;
2. Guarantee the shareholders' rights and of those holding key positions related to ownership;
3. Provide fair treatment to all shareholders (including foreign and / or minority), reiterating the need to ensure compensation for all those whose rights have been violated;
4. Recognition of the shareholders' legal rights, respectively of the cooperation between shareholders and companies in the field of generating added value and jobs;
5. Providing an accurate picture of performance, capital, financial position and entity governance through a fair and transparent reporting system;
6. Clearly defining responsibilities of the Board of Administration to ensure effective strategic coordination of the entities and effective supervision of executive management.

Currently, the OECD principles are universally recognized as one of the 12 basic standards of a solid financial system. They serve as a frame of reference for the national corporate governance codes in the EU countries and beyond.

The set of corporate governance principles were initially focused on the efficient administration of the stock entities. Later on, this concept was extended to other types of organizations. For this reason there is a strong focus on the role and rights of shareholders, the transparency of information and the crucial importance that some company managers have. A basic element of the principles is the transparency of financial and accounting information because it underlies the decisions of the information users. The quality of this type of information plays an overwhelming role in the efficient management of entities, leading ultimately to the increase of their market value.

Internal Audit – An Essential Element to Improve the Process of Corporate Governance in Organizations

A multitude of accounting and auditing studies have highlighted the role of corporate governance through the "Agency Theory" examining the way in which monitoring made by the board of directors and audit committees was oriented to ensure the protection of shareholders' rights.

Audit committees must have a comprehensive general structure, incorporating elements of corporate governance, risk and control. Without such an efficient structure, monitoring itself is a potential risk. Therefore, many organizations are now involved in complex processes to eliminate redundant control functions and inefficient methods used in risk communication.

It is known that most of the times managers and shareholders of an entity have different pecuniary interests. Corporate governance brings to the fore precisely this type of relationship, a mismatch between the interests of owners and managers.

Managing financial resources and patrimonial values of other persons, managers do not show the same vigilance and care that the members of a company manifest in ensuring their financial stability and welfare.

In this context, supervision is the solution that provides a solid operating basis for an entity. This requires the adoption of the entity's internal regulatory framework uniquely defined, designed to ensure the implementation of risk management and internal control systems.

Internal audit is part of the process of proper control systems. If the auditor's opinion and recommendations are made without reservations about the financial statements and financial reporting framework, the entity must properly manage all the activities and the information recorded in the accounts should reflect as accurately as possible the transactions that have occurred in a certain period of time.

The audit mission also requires the auditor to increase the effort of identifying the possible manipulation of the information provided by the accounting department because there may be situations in which managers take advantage of the lack of expertise of the owners and report "embellished" or false performance.

It is clear that inefficient governance provides opportunities to express creative accounting. Removing such difficulties represents one of the functions of the internal audit department, which must be able to identify threats and elaborate efficient management strategies.

Everyone involved in the corporate governance system should evaluate the risk management system and that of the internal control in a comprehensive manner because poor governance generates manipulative behaviors.

A complete and cross-functional approach of the threats evaluation process is a key element of corporate governance. This process must be oriented in the following directions:

- Know all significant risks;
- Identifying risks at global level;
- Ensure that risks are clearly identified and correctly correlated with the entity's objectives;
- Promote appropriate and proportionate allocation of resources to control and monitor risks in relation to their importance;
- Respect the principles and the codes of good practice.

All these are meant to direct managerial leadership for the proper functioning of the organization, thereby maximizing the shareholders' interests. Therefore, the task of internal audit is to watch over the interests of all parties involved.

Internal audit in the context of corporate governance has gained an increased importance in time more precisely due to his active role in the evaluation of internal control and risk management as they have direct consequences for financial reporting.

In this regard, the Standard 2130 of the Institute of Internal Auditors emphasizes that: "the auditing activity should evaluate and make appropriate recommendations to improve the corporate governance process in the following objectives:

- promoting appropriate ethics and values within the organization;
- ensuring effective organizational performance;
- effective communication of risk information and control in appropriate areas of the organization;
- effective coordination and communication between the board of administration;
- external and internal auditors and management".

Therefore, the results of the internal audit activity aim at improving the entity's corporate governance.

Conclusions

As a result of the current research, we consider corporate governance as a process implemented in order to reduce the effects of the current economic crisis and as a component of a more complex set of solutions that could be the way out of the crisis through the following measures:

- to ensure transparency, fairness and reliability of the financial and economic information;
- to harmonize the interests of related parties on the proposed objectives;
- to develop and implement a range of strategies aimed at limiting risks;
- internal audit, as a key component of corporate governance, should be exercised in relation to a system of internal control, an

accounting systems and financial and accounting reporting which should equally serve investors, beneficiaries or users of the information from reports of any kind.

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