INTERNATIONAL JOURNAL OF ACADEMIC RESEARCH IN ACCOUNTING, FINANCE AND MANAGEMENT SCIENCES

HR MARS MANAGEMENT ACADEMIC RESEARCH SOCIETY
EXPLORING INTELLECTUAL CAPITAL
www.hrmars.com
ISSN: 2225-8329

Corporate Governance and Audit Activity

Gheorghe Lepadatu

To Link this Article: http://dx.doi.org/10.6007/IJARAFMS/v3-i2/10456 DOI:10.6007/IJARAFMS /v3-i2/10456

Received: *11* April *2013*, ***Revised:*** *15* May 2013, ***Accepted:*** *27* May 2013

Published Online: 18 June 2013

In-Text Citation: (Lepadatu, 2013)
To Cite this Article: Lepadatu, G. (2013). Corporate Governance and Audit Activity. *International Journal of Academic Research in Accounting Finance and Management Sciences*, *3*(2), 77–84.

Vol. 3, No. 2, 2013, Pg. 77 - 84

http://hrmars.com/index.php/pages/detail/IJARAFMS	JOURNAL HOMEPAGE

INTERNATIONAL JOURNAL OF ACADEMIC RESEARCH IN ACCOUNTING, FINANCE AND MANAGEMENT SCIENCES
www.hrmars.com
ISSN: 2225-8329

Corporate Governance and Audit Activity

Gheorghe Lepadatu
Faculty of Finance, Banking and Accountancy, "Dimitrie Cantemir" Christian University, Bucharest, Romania
Email: cilezbujor@yahoo.com

Abstract
Transparency of information, indispensable for competitiveness in the market is an efficient operation of corporate governance systems, especially control systems. The issue of governance should be seen as a fundamental pillar of fraud against the pressures to induce frauds, due to lack of transparency of information flow. In all models of corporate governance, external regulation covers a primary role in ensuring effective controls, but it remains the responsibility of the entities to adopt a virtuous mechanism under the profile of internal controls. Corporate governance is closely linked to the entity's management and its structures, knowing the fact that this concept covers important issues in the area of social responsibility and ethical business practices. Corporate governance includes elements such as transparency and financial audit, internal audit, having a close relationship with financial reporting and financial disclosure required by internal and external users. Corporate governance is an attempt to stop the spectacular failures of the private sector and to regain confidence in business. Our research concluded that these failures were the root of evil in the internal control system defective and low strategic level (corporative one) of the management. Improving corporate governance must be improved simultaneously with the application of International Accounting Standards and international reporting.
Keywords: Corporate Governance, Internal Audit, IAS/IFRS.

The Scope and Purpose of Corporate Governance

Corporate governance is the system of rules and norms, either institutional or market, within which arise or are pursued various categories of stakeholders, shareholders, management, public administration, personnel, customers, suppliers, etc.. This definition should be completed with the expressly stated objective supplemented by the „Principles of Corporate Governance" issued by OECD (1999), i.e. „providing company's strategic direction, effective control management of the board members, trust and loyalty of the shareholders".

Systems of governance have in fact two main objectives: ensuring the integrity of the management and to guide it to maximize the value created for shareholders. In the pioneer countries in corporate governance, such as the U.K. and U.S., public regulations follow the private ones. Continental European countries, notably in Italy and France, market regulation and companies' management is prevalent public, this difference having a substantial meaning – the „origin" public intervention is inserted in a context less receptive and exposed to many environmental adverse conditions.

Generally pointing out, in Europe and especially in Italy, Germany, France, ownership and control of listed entities should be heavily concentrated on property attributable market share, understood as a set of minority shareholders.

In the UK and U.S. equity listed entities is spread at a rate of about 90% on the market, as fewer cases of legal or factual control. It can be observed how in non-Anglo-Saxon world is manifested prevalence concentration of control of listed companies: the law, when a subject controlling majority, in fact, in the absence of other strong shareholders, a share below 50% is sufficient to ensure the most.

The purpose of an effective and functioning corporate governance structure, able to ensure the integrity and respect of all categories of stakeholders, the issues which arise relate to the possible costs of controlling the separation of ownership from control. Irrespective of the reasons that lead to fraud in the typical European and Anglo-Saxon at both shareholder control and manager controller, non-owner, can assign privileges to different types - economic or not, absolutely unjustified over the interests of minority shareholders and society, where a diffuse property, no shareholder is able to control the activity of the manager responsible for economic resources.

Models of Corporate Governance

There are two models of corporate governance: a model “outsider system” and model “insider system”. These models of corporate governance depend fundamentally on the conception of the separation between ownership and control. In the model of “outsider system” defined also as “market oriented”, the relevant categories of companies are so-called “public companies”, characterized by an increased fraction of the property, typical for companies listed on regulated financial markets and by a low concentration of ownership.

Such a model of corporate governance characterized the Anglo-Saxon and American countries, where the system of “common law” - the degree of protection of minority shareholders and creditors - is very high and the property company is widely prevalent. In the model of “insider system”, defined as the model “rin”, the property is highly concentrated, with a strong decision-making role in few or single groups, with a familiar character or bank.

Such a model of corporate governance characterize the European countries, especially Germany, Switzerland, Austria, France and Italy (with certain features), where the listed company ownership and control are highly concentrated, and the share attributable to property market is relatively small (understood minority shareholders as a whole).

Systematizing, we can say that it is possible to relocate the typical characteristics of the two models as follows:

a) The “insider system” model, market oriented or market-based system, characterized by the following:

- the property (capital) concentrated in banks and families represents often the reference shareholders
- the normal control is exercised by shareholders, with no real market control
- the capital market is relatively non-cleared;
- there are contracts and very close trust relationships based on personal relationships between owners, managers, suppliers;
- the central role of the banks.

b) The “outsider system” or Anglo-Saxon system is characterized by:

- diffuse ownership;
- very liquid capital market;

- very diffuse market for control, on continuous improvement "take over" for underperforming companies;
- major attention and interests of shareholders, especially minority.

A classification table of the two models of governance could be shown in the following manner:

Characteristics of Two Models of Corporate Governance

Features	Market-based system	Credit system
The loan / venture capital	Low	High
Concentration of capital	Medium – low	Medium-high
Cross capital	Little diffuse	Very diffuse
Separation of ownership-control	Very emphasized	Small emphasized
The monitoring model	External (external threat)	Internal
The market model of shareholders	External	Internal
Number of listed companies	High	Low
The presence of groups	Medium – low	Medium - high

Another possible classification would be based on the relationships between different bodies of management. In particular can be distinguished two types of structures of the organs of society:

- the type of "one-tier system", providing a single governing body with responsibilities for managing and monitoring the management company, the relevant body being the "board of directors", which refers to specific directives belonging to senior executives, expression of management or non-executive, named "outside directors", an expression of shareholders. Those systems are especially characteristic of economic areas in the U.S., UK and Southern European countries (Spain and Portugal), having certain characteristics;
- the type "two-tier system", where decision-making power, control and management are entrusted to two bodies, separated, with different responsibilities (Supervisory Board has no executive power, appoint, supervise and dismiss the management board, which, in turn, has executive responsibility for the role). These systems are typical for economic areas in Germany, Switzerland, Austria;
- there are also hybrid models (e.g. in France and in Italy), where it is possible to find elements of both structures.

The Role of Internal Audit in Preventing Fraud

Any type of corporate governance, irrespective of the reference configuration and the market, should be considered effective if it could provide appropriate control mechanisms that intervene in critical situations and protect the interests of all users.

The factors underlying the accounting fraud risk are related with reduced distribution functions of internal audit, with an internal control system which does not comply fully with the economic exigencies of companies and more aggressive accounting policies.

The most effective instruments, individualized to prevent fraud out are two: management control and internal audit operation.

Internal audit is the responsible to provide its own support, assessing risks and control strategies of the organization, suggesting initiatives, solutions, proposals and recommendations to mitigate the threat of fraud and improve control strategies.

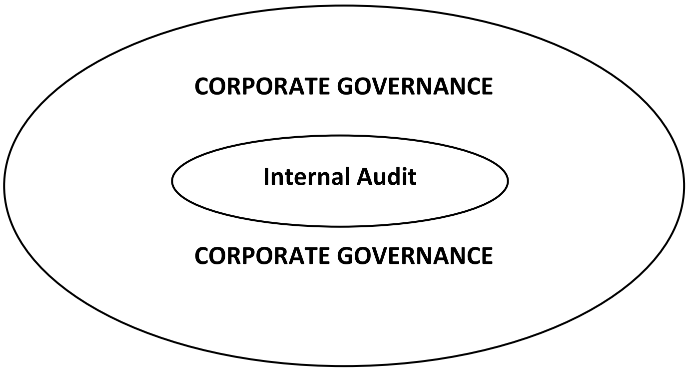

Figure 1. Internal Audit System

Internal audit should add value to all organization's activities, facilitating the identification and assess risks at all levels. Internal auditors should, inter alia, to take full defined responsibility in preventing, identifying and reporting fraud, and must implement actions aimed at creating „awareness”. Auditors and organizations might let the staff help addicted clients, shareholders and other users involved in the fight against fraud at all levels and on all fronts.

Control Environment - Targets - Monitoring

The control environment is one of the important elements needed for enterprises to organize an effective internal control system. Thus, we face:

- ***a favorable control environment***, which implies a climate where ethical values are privileged, uses, supports and appreciates the control, which means that the internal regulations and codes of ethical conduct exist and are taken into account all factors, including by general management

Overall management model should be used not only in speech, but also to personal conduct and third parties (customers, suppliers, etc.). Only in such environment, internal control will work, will grow up and develop;

- ***an appropriate control environment***, which respects the laws, rules, procedures, third parties, partners, employees, contracts and so entity's activities are mastered;
- ***a damaged control environment***, there is no formalized procedures, avoid controls, there are breaches of rules of conduct and rules of operation or even breach the legal framework - however damaging to the internal control.

Structurally, the most important controlling factors that decisively influence the control environment are: the functionality of management structures, management policy and its operating style, organizational structure of entities, the manner of authority and responsibilities, managerial system control, which includes the internal audit function; mode of segregation of duties.

The cornerstone of an entity's internal audit is a system of analysis and risk assessment. Risk assessment involves defining goals and conditions that must have regard in particular to managing change, taking into account the fact that people change, change procedures,

Vol. 3, No. 2, 2013, E-ISSN: 2225-8329 © 2013 HRMARS

political organizations are changing, and hence the risks are changing and, consequently, internal control is condemned to a permanent adaptation to new conditions.

Proposal for an Operational Model Group

The proposal for a model group on the principle of corporate governance should include internal control, internal audit and corporate organizations.

Priorities to be considered in adopting a governance model are:

- rationalization of the governing bodies (Boards and Committees);
- determining the powers and responsibilities of existing internal control system;
- recognition of existing internal control.

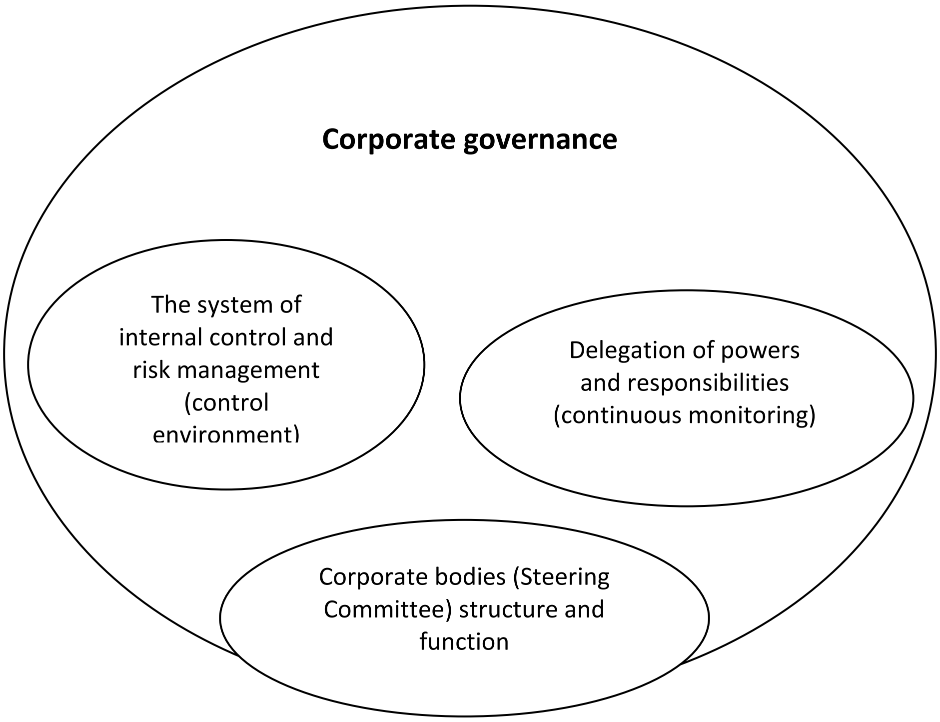

Figure 2. The priorities of a corporate governance model

Codes of Conduct and Standards of Reference in Various Countries

Countries	**Codes of conduct and standards of reference**
Italy	*Self-discipline code (Stock Italy)-Vietti reform / Decree Law 262/2001*
Germany	*Kon Tray; German Corporate Governance Code*
France	*Raportul Vienot; Nouvelles Regulations Economiques; Loi sur Sécurité Tinaciare- 2003*
U.S.A:	*COSO-Report; Sarbanes & Oxley Act*
U.K.	*Cadbury Code/Combined Code/Higgs Report*
Spain	*Riuz Code/Codiqo Olivencia*
Belgium	*Law Nr. 08/2002*
Mexic	*Code of Corporate Governance*

Corporate Bodies - Structure and Function in an Optimal Model of Corporate Governance

- Board of Directors, its role within the group companies and management control activities;
- procedure for nomination and election of the membership of the Board of Directors;
- presence of the Directors in the Board;
- rules that discipline at the group level, the powers of the Administrative Council;
- formal recognition of the Governing Board;
- presence of the Audit Committee and Human Resources.

From the matching corporate to internal control system following requirements is compulsory:

- a system of internal control officially approved at group level;
- formalized procedures;
- integrated identification and management of financial risks;
- code of ethics/formal conduct widely distributed;
- disciplinary systems/sanctions;
- imposed rules;
- internal corporate governance guide;
- internal audit standards manual.

Internal control system functions should include: internal audit, the Audit Committee, Business Risk Management. In an optimal model of corporate governance some key characteristics of internal audit independence and objectivity are represented by independence and objectivity.

The Audit Committee is a body nominated by the Board of Directors composed of at least three members, of which at least one must meet the independence requirements. At least two members of the committee have significant and recent experience in accounting and finance. In fact, audit committees have four or more members of which at least half are employed, including identifying and President. Each committee, through its Web site, has access to data and economic information of interest and considers the work of committees in other countries and exchanging documents and experiences it. At least once a year, all members of audit committees meet in a meeting to present their work and define the priorities of programs and future activities. This is actually a network and a professional community.

Conclusions

A new approach to regional organization should aim at improving the processes of "corporate governance" within the group. Internal Audit and the Audit Committee will adopt a "new approach to regional coordination", to focus especially on: increasing areas of activity covered by the control and implementation of a certain frequency, the deeper penetration of the local business to achieve a group approach, maintaining operational efficiency in terms of cost, an important role in monitoring the exercise group.

Better corporate governance requires the group to adopt a methodical approach to risk management to protect the interests of stakeholders and shareholders (creating and maintaining the value of ensuring that the Board monitors the performance and support policies generate value) and ensure the existence of operational controls.

References

Niculescu, M. (2005), „*Diagnostic financiar*”, volumul 2, Editura Economică, Bucureşti.

Paraschivescu, M. D., Radu, F. (2008). „*Managementul contabilităţii financiare*”, Editura Tehnopress, Iaşi.

Păvăloaia, W., Paraschivescu, M. D., Olaru, G. D., Radu, F. (2006). „*Analiză financiară. Studii de caz*”, Editura Tehnopress, Iaşi.

Spătaru, L. (2004). *„Analiza economico-financiară*”, Editura Economică, Bucureşti.

Vâlceanu, Gh., Robu, V., Georgescu, N. (2005). *„Analiză economico-financiară*”, Editura Economică, Bucureşti.

Lepădatu, Gh. (2010). *”Standarde, teorii si sisteme de conducere a contabilitatii pe plan mondial”,* Editura Pro Universitaria, Bucuresti.

Lepădatu, V. Gh. (2008). „The actuarial accounting in the modern financial-accounting management with applications to the corporate units in the steel industry”, *Metalurgia International*, nr. 2 special, pp. 5-11.

Lepădatu, V. Gh. (2009). „From the cost accounting to the management accounting according to the national reference mark of financial report”, *Metalurgia International*, nr. 1 special, Bucureşti, pp. 5- 8.

Lepădatu, V. Gh. (2009). „Property, plant and equipments in the metallurgical field (IAS 16), *Metalurgia International*, nr. 2, Bucureşti, pp. 53-59.