

COMPLIANCE AND INDEPENDENCE IN CORPORATE GOVERNANCE

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Abstract: Globalization and internationalization of businesses led to the increase of the complexity of governance processes of organizations, to the amplification of risks and uncertainties in the context in which the stakeholders' expectations are greater. The assignment of resources and responsibilities to the executive management and supervision of organizations implies inclusively disclosure practices regarding both the expected and accomplished performance, and the responsibilities of corporate executives according to the requirements established through applicable regulations. The process of governing an organization can be considerably improved if the appeal to compliance and independence represents open directions of actions of corporate executives. Important professional judgements must be disciplined that the answer to the question "How can the credibility of an organization be assured?" to be found within the area of compliance and independence requested and asserted in corporate governance.

Keywords: corporate governance, independence, compliance, managing board, credibility

1 Introduction

In recent years the role of corporate governance of organizations has grown especially on capital markets. The causes approach the pressure of the globalization process, of competition, of the turnover of capital flows, of new technologies, of trends of incorporation of big joint stock companies. They created new requirements related to the knowledge, to the comprehension of differences and convergences among practices of corporate governance, to the consideration of new opportunities for assuring the continuity of organizations. Investors' interest gets itself noticed within the development of the normative framework of corporate governance according to the stakeholders, mainly in the context of capital markets.

Corporate governance is defined in different ways. Some concepts present it as the system through which an organization takes and implements decisions regarding the achievement of goals¹ or a framework whereby an organization is managed and controlled with a focus on the monitoring of the activities of management in order to diminish risks which may prejudice inappropriate behaviours². Besides, corporate governance is seen differently from the point of view of corporate executives' expectations. Eloquent on this line there are the codes of corporate governance, some with requests for voluntary disclosures from the responsible ones, others with strict requests for compliance and explanations in case of noncompliance. Therefore, there can be made references to: *The Nørby Committee's Report*³, more recent *Recommendations on Corporate Governance*⁴ in Denmark; *The Cromme Code*, Germany⁵; *The Preda Code*, Italy⁶; *The Cadbury Report*, UK⁷; *The Greenbury Report*, UK⁸; *The Combined Code*⁹, more recent *The UK Corporate Governance Code*¹⁰.

¹ Crowthe, D; Seifi, S. (2011) *Corporate Governance and International Business*, pp.10-12.

² Sifuna, Anazett Pacy, (2012), *Disclose or Abstain: The Prohibition of Insider Trading on Trial*, Journal of International Banking Law and Regulation 27 (9) .

³ Copenhagen Stock Exchange (2001), *The Nørby Committee's Report on Corporate Governance in Denmark*.

⁴ Ida Rosenberg - Danish Business Authority (May 6, 2013), *Recommendations on Corporate Governance*.

⁵ [Government Commission on the German Corporate Governance Code](#) (February 26, 2002), *The German Corporate Governance Code (The Cromme Code)*.

⁶ Committee for the Corporate Governance of Listed Companies, Borsa Italiana (October 1999), *Report & Code of Conduct (The Preda Code)*.

Recommendations regarding the compliance for the European countries can be found also in *The Green Paper*¹¹. Corporate governance represented the object of numerous researches with results published in studies and treatises elaborated by: Love, I., Rachinsky, A., (2007)¹², Campbell D.(2008)¹³, Dănescu T. și Spătăcean I.(2008)¹⁴, Ghiță, M.(2008)¹⁵, Bowman B. (2010)¹⁶, Goergen, M., (2012)¹⁷.

2 Research methodology

Knowing the compliance and the significant aspects of the independence in corporate governance supposed also a theoretical documentation and an empirical research on practitioners' perceptions over financial audit. The theoretical documentation was focused both on studies considered to be relevant from the point of view of the analyses, of the comparisons made on the analysed theme, and on a survey over the requirements from specific laws and regulations published in many European countries.

The target group of the research was formed by financial auditors and probationers in financial audit; some of them are employed in organizations in financial-accounting activities, in many cases into the management, audit committees, supervisory boards. When approaching the intercessions of the research over practitioners' perceptions in the financial audit regarding the two sides that were studied in relation with the corporate governance – compliance and independence – there were important the experience and the degrees of knowledge about accounting and financial audit practices as initial point when making up the applied questionnaire and when selecting the elements of the given specimen of 43 respondents (practitioners in the financial audit and accounting activities from the counties: Mureș, Cluj, Bihor, Sălaj).

The work elements chosen and formalized in a questionnaire consisted of some questions addressed in multiple choices, but also in open questions, so that respondents' judgements would find their materialization in the most adequate answers on the basis of the encountered practices and of the own experience.

3 Premises for compliance in corporate governance

Compliance is instituted by a set of rules imposed in the management and supervision of an organization. These rules are established not only by laws, regulations and other regulatory documents of the governmental and supervisory bodies existent in a jurisdiction or

⁷Financial Reporting Council (FRC) London Stock Exchange (1992), *Cadbury Report(The Financial Aspects of Corporate Governance)*, http://www.ecgi.org/codes/code.php?code_id=132, accessed in 02.04.2014.

⁸ Confederation of British Industry (CBI), July 15, 1995, *Greenbury Report (Study Group on Directors' Remuneration)*.

⁹ Financial Reporting Council (FRC), (June 2008). *The Combined Code on Corporate Governance* (Revised in June 2008) .

¹⁰ Financial Reporting Council (September 28, 2012), *The UK Corporate Governance Code*.

¹¹European Commission, Brussels, 5.4.2011, COM (2011) 164 final, *Green Paper*, The EU corporate governance framework.

¹² Love, I., Rachinsky, A., (2007), *Corporate Governance, Ownership and Bank Performance in Emerging Markets: Evidence from Russia and Ukraine*, Working Paper: http://siteresources.worldbank.org/DEC/Resources/Corporate_Governance_Ownership_and_Bannk_Performance.pdf.

¹³ Campbell D, (2008), *Between Rules and Principles. Corporate Governance Codes – a comparative analysis*. Audit Financiar Magazine, no. 11/2008.

¹⁴ Dănescu, T.; Spătăcean, I.(2008), *Corporate Governance – principles applicable to entities listed in a regulated market*, Audit Financiar Magazine, no. 8/2008.

¹⁵ Ghiță, M.(2008), *Corporate Governance*, Economică Publishing House, Bucharest, p. 13.

¹⁶ Bowman B.(2010), *Principles and Recommendations Proposed in a Corporate Governance Code*. Audit Financiar Magazine, no.10/ 2010.

¹⁷ Goergen, M., (2012), *International Corporate Governance*, Harlow, Prentice Hall, p.336.

market, but also by “traditions and behaviour patterns developed by each economy and juridical system”¹⁸. Moreover, organizations have their own culture, a set of goals they want to achieve in the intercession specific to the business cycle. In this context, the compliance mechanisms of the corporate governance are applicable in circumstances that vary through the requirements of disclosure and the requested explanations.

The compliance mechanisms generally refer to and supervise the way in which corporate executives comply with the legal rules imposed when assuring the management of an organization. They differ mainly subject to the organizational magnitude and complexity, to the shareholding structure, to the maturity of the business, of the corporate lifecycle. The area of compliance mechanisms is extended also on a set of internal requirements, inclusively of behaviour and ethics established within any organization.

The evolutions recorded in recent years show continuous changes in the dimension of corporate governance; therefore, the flexibility of legitimating and applying corporate practices represents a main condition of the continuity of each organization. A proof on this line are the corporate researches made over the corporate governance codes which, under the aegis of the principles of Corporate Governance legitimated by OECD (1999)¹⁹ illustrate the evolution of the requirements for compliance, especially related to: the correct and equitable assurance of all stockholders’ rights, the assumption of corporate responsibility, of the managerial board and of the supervisory board responsibility, the assurance of transparency from the point of view of the corporate structure and function, of the protection of the structure and the governance of the property.

By means of the additions brought to the requirements from laws and other applicable regulatory documents, of the requested disclosures, the provisions of corporate governance codes help the investment performers to focus their attention on the practices of an organization, on the analysis and test of corporate executives’ performance within an organization. Proofs related to the role of the compliance and of the implementation of compliance mechanisms established by the adopted compliance codes are given by The Comparative Study of Corporate Governance Codes²⁰.

This shows that England has one of the widest experiences from the point of view of disclosures made in the annual reports regarding the compliance with the best practices, the *Cadbury Report* being exemplifying on this line. An eloquent aspect is represented by the acknowledgement that the publication of declarations of conformity increases concomitantly with the increase of the number of non-executive members of the Supervisory Board and of the Audit Committee²¹. Researches made in Netherlands by Tilburg University²² show that the presentations of compliance rules are generally related to requirements from laws and some regulatory documents other than the ones established by governance codes regarding stockholders’ rights. Therefore, only 55% of the companies have ampler disclosures of the requested compliance information. In Belgium²³ the Banking and Finance Commission identified only 27.5% of the organizations with more considerable presentations of

¹⁸ Committee for the Corporate Governance of Listed Companies, Borsa Italiana (October 1999), *Report & Code of Conduct (The Preda Code)*, pag. 12 A.

¹⁹ The Organisation for Economic Cooperation and Development (2004), OECD – *Corporate Governance Principles*, <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf>.

²⁰ Weil, Gotshal and Manges, (2002), *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States – Final report and Annexes I-III*.

²¹ Financial Reporting Council (FRC) London Stock Exchange (1992), *Cadbury Report (The Financial Aspects of Corporate Governance)*, http://www.ecgi.org/codes/code.php?code_id=132, accessed in 02.04.2014.

²² Committee on Corporate Governance, Abe de Jong - Tilburg University (1997), *Peters Report & Recommendations, Corporate Governance in the Netherlands*.

²³ Commission Bancaire et Financiere, *Guidelines on Corporate Governance Reporting*, November 1999.

compliance information. The Portuguese Security Market Commission (CMVM)²⁴ concluded that only 23.2% of the organizations declare trenchantly that they comply with the requirements established for the rated companies.

4 Significant aspects related to corporate executives' independence

Important judgements and comparisons are made on the benefits of the best corporate governance practices; there are also weighted up the advantages and opportunities of a management and supervisory system of the organization on a level (a unitary system) or on two levels (a dual system in which a level is for the supervision and the other one for the executive management). The situations from the European countries are different. If in Germany or Austria there is a predominant dual governance structure, in most of the European countries there is a unitary governance structure. There are also situations in which the framing in one or in the other system generates pros and cons. For example, in Finland is the case of a management committee with a chief executive detached from an administrator; in other European countries there is a management committee detached from an audit committee. In all cases the difference is clear from the point of view of the existence of a supervisory position and of an executive management position; the difference appears through people who are invested with the responsibilities of the two positions, namely: if they are the same for the supervisory position, and for the executive management position or they are different for each of the two positions (the ones from the executive management become in turn supervised).

Each corporative system of management has certain benefits and when comparing them one analyses their objectivity²⁵ when assuring the supervisory and managerial responsibilities. Therefore, their effects affect transparency, the utility of financial information pursuant to the loyalty with which they represent the performances of the organization²⁶; they endorse the credibility perceived by the concerned parties, mainly by the ones from the exterior of the organization. And this is due to the fact that there are proved situations when through the applied reporting practices the management may mislead the concerned parties because of some corrupted or deficient provisions of financial information²⁷.

Irrespective of the applied governance system, the corporate governance codes point out the need to name some non-executive persons, more some independent persons for the supervisory position. With regard to independence, there are different dimensions of its evaluation and acknowledgement. But certainly, independence implies the absence of a relationship (relational, familial, business-like, of significant interest) between the executive administration and the ones who assure the supervision of the organization, including the members of audit committees.

The best practices registered in the corporate governance codes impose the disclosure of the necessary information for the issuance of reasoning about the independence of corporate executives, alongside of information referring to their experience, competences, availability and other qualities considered to be important when carrying out their duties. The requests for information in the context refer to personal qualities of appropriation towards the

²⁴ Comissão do Mercado de Valores Mobiliários (CMVM), (December 2001), *CMVM Regulation No 07/2001: Corporate Governance*.

²⁵ Dănescu T., (2007), *Financial Audit – convergences between theory and practice*, Irecson Publishing House, pag.185.

²⁶ Dănescu Tatiana, Prozan Mihaela, Dănescu Andreea, *The Informational Risk – Operational Research Over The Net Accounting Result*, 2013 Conferences Alba Iulia.

²⁷ KPMG LLP (2011), *Elevating Professional Judgement in Auditing: The KPMG Professional Judgement Framework*, KPMG, pp.1-2.

ones from the executive administration, of remuneration, of property, but also to the practices and social relationships in which they are involved and which could generate a significant influence. Moreover, referring to the managing director's independence, The Hampel Report, UK²⁸ refers to the capacity of thinking independently, to the quality of the named one not to regard his position as a prize for his good performance. There also becomes important the exclusion of costs of the “groupthink” behaviour that may result in the loss of the consequences of an independent reasoning²⁹, in the elimination of critical evaluations and of different points of view³⁰.

The request for independence also represents an important means when finding some viable solutions for the diminution of conflicts of interests³¹. The identifications of threats regarding the independence impose counter measures, inclusively when disclosing them to the stakeholders³².

5 Results of the analysis of perception over compliance and independence

In the empirical study were allocated four questions in order to obtain an image of respondents' perception over compliance and three questions in order to obtain an image of respondents' perception over independence. Processing the respondents' answers to the first question related to compliance – *Name the modality in which the declarations of conformity are made by the corporate executives from your organization, declarations related to the compliance responsibility published for the financial statements: 1-taken over and assumed; 2-explained with a presentation of the circumstances.* – resulted the fact that the organizations are apt to comply rather to explain the fact that leads to a mechanical assumption of the compliance requirements, to a unification of the decisions in this context. Therefore, 79% of the respondents consider that compliance requirements which consist of corporate executives' declarations are rather taken over (there are specifications about a “mechanical” takeover) and assumed that presented with explanations relevant to real circumstances. In this context, there may be taken into consideration if the compliance requirements express or don't express a coercive pressure under corporate executives, if the nature of corporate executives' declarations is the result of a common assumption and acceptance of them or the manifestation of an attitude like “all do this”.

The situations in which compliance gathers way in the dimension of the intrinsic target figures institutional next to the ones impose by governmental and supervisory bodies in a jurisdiction or market regard mainly organizational aims referring to the continuity of the business, its performance, the transparency of information published in the financial statements.

The perception expressed from this point of view by the participants to the empirical study, by means of the answers given to the question: *Do you appreciate the importance given by the management of the organizations you work in or you collaborated with to the following three organizational aims: performance; continuity of the activity; transparency of published information.* – show the degree of interest of the corporate management for the aims formalized, implemented and monitored on the three strategic lines. Therefore, according to

²⁸ National Association of Pension Funds (NAPF), London Stock Exchange, Confederation of British Industry (CBI), Institute of Directors (IOD), Consultative Committee of Accountancy Bodies (CCAB), Association of British Insurers (ABI), *Hampel Report* (UK, 1998), Norma 3.6.

²⁹ M.E. Turner, A.R. Patkanis, (1998), *Theoretical perspectives on groupthink: A twenty-fifth anniversary appraisal Organizational Behaviour and Human Decision Processes*, Vol. 73, pp. 103-104.

³⁰ Kamau C., Harorimana D. (2008), *Does knowledge sharing and withholding of information in organizational committees affect quality of group decision making?*, *Academic Publishing*, pp. 341 – 348.

³¹ Goergen, M. *International Corporate Governance*, Harlow, Prentice Hall, 2012, p.336.

³² Dănescu T., (2007), *Financial audit – convergences between theory and practice*, Irecson Publishing House , pag.198.

the appreciations expressed by the respondents for an importance degree conferred by the management at the highest level (*very important*), the aims related to the *continuity of the activity* stay on the top (83% of the respondents consider that they are attached a high importance), the aims related to *performance* play second fiddle (75% of the respondents' answers) and the aims related to *the transparency of published information* are on the third place (67% of the respondents' answers).

By virtue of the presented aspects, it is eloquent the need to become conscious of the increase of the importance attached to transparency for a good working of the whole information chain completed periodically with feasible evaluations and published reporting; implicitly, they become an important agent when assuring the credibility of an organization and, therefore, when recognising its success by the investment performers.

Reporting the compliance in the corporate governance imposes, first, judgements for an ample, complex and complete process of implementation and monitoring of corporate responsibilities, with clear mechanisms of establishing, formalizing, communicating and monitoring. Second, obtaining a feedback on the functionality of the whole process is a decisive factor for the Supervisory Boards members' awareness related to the impact of their decisions on the achievement of the goals of the organization, as well as to the appreciation of their responsibilities. From this point of view, according to the formulated answers, the respondents consider that the responsibilities of the Supervisory Boards members: were clearly established and formalized in 30% of the organizations; were clearly established, formalized and communicated to the insiders in 58% of the organizations; were clearly established, formalized, communicated to the insiders and there is a direct reporting line towards the Supervisory Board and the Audit Committee in 12% of the organizations.

Carrying on the intercessions of research made on the perceptions related to compliance in corporate governance, introducing new elements that collates its accomplishment level, on the basis of the respondents' answers there resulted the fact that the organizations established and report financial performance indicators; as for the nonfinancial indicators of compliance, the situation is as follows: it exists and it is applied in 46% of the organizations; it exists and it is often applied in 32% of the organizations; it exists, but it is sometimes applied in 15% of the organizations; it exists, but it is not applied in 6% of the organizations; it does not exist in 1% of the organizations.

The results of the empirical study made in relation with the independence demonstrates that its perception in terms of the independent members of the Supervisory Board and of the safeguard procedures applied for the assurance of independence show that: 76% of the Supervisory Boards that include independent members and attach importance to the adoption and application of the measures for independence, while 16% adopted measure for assuring the independence, but do not apply them, and 8% did not talk it up the adoption of measure for assuring independence.

The chart of the results related to the level of influence and involvement in the organization of the Supervisory Board leads to the idea that: there is involvement and there is distinguished the influence of the Supervisory Board (answers given by 53% of the respondents); there is involvement, but sometimes there is not distinguished the influence of the Supervisory Board (answers given by 35% of the respondents); there is no involvement and there is not distinguished the influence of the Supervisory Board (answers given by 12% of the respondents).

Another important aspect for the image over the independence is represented by the perception related to the separation of duties regarding the supervisory and executive management position. Therefore, in 36% of the given answers it is recognized the implementation of the separation of responsibilities of supervision and of executive management, in 55% of the cases it is declared that there were formalized separated

responsibilities for the two positions, but sometimes there are interventions in the supervision made by the executive management and in 9% of the given answers it is asserted that formalization and adoption of separated responsibilities for the two positions are not known.

6 Conclusions

Numerous traps and prejudices which throw into the background the quality of the corporate governance process find their origin in noncompliance and threats at the independence. Even if this process may be impartial, objective, but also coherent and flexible, the lack of some instruments adequate to recognize its credibility leads to undesirable effects on behalf of the stakeholders of an organization, because there appears the apparent vulnerability with the predictable traps and prejudices. In this context, even if, on average, the situation seems favourable, the nuances appeared from the research lead to the establishment of new key factors; they would determine the corporate executives in relation with the development of rules through which compliance would be assured and reported, mainly when periodical evaluations show weak points, noncompliance of the mechanisms that assure compliance, even if the developed effects are insignificant. It becomes important that they should be obligatory published in order to be known by stakeholders, situation that would lead to the empowering those in question.

From the point of view of independence, it is relevant the situation of asserting new perspectives related to the a higher transparency regarding the compliance and, therefore, to the compliance level if in the corporate management increases the number of independent members and if there are applied procedures of collecting and implementing recommendations from independent members or interested parties.

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