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The development of a corporate governance assessment model for the Romanian public sector

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Abstract

Corporate governance is an essential component of business management, and has acquired a particularly important momentum in the private sector, in the context of the economic crisis and financial maneuvers which are questionable in terms of legality. The same imperative need to develop corporate governance is also identified in the public sector, given the large number of stakeholders and their heterogeneity, the need for accountability, efficiency, performance, transparency and sustainability. By using a qualitative research approach, a set of ideas on corporate governance was presented, as published in the specialized literature; also, a model was proposed for the assessment of corporate governance in the Romanian public sector. In the current context, the development of such a model complements the informational valences in the literature regarding the corporate governance, allows the identification of the deficiencies in the governance of Romanian public institutions, and creates the potential for the development and implementation of a governance code dedicated to the public sector.

Keywords: *Corporate governance, assessment model, public institution, stakeholders, Romania.*

JEL Classification: *M48, L38, G34, H83.*

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Introduction

The premise of the research is the limited transparency of financial and nonfinancial public sector information in Romania, in the context of public resources cuts, the imbalance of the public services demand and supply in terms of quality, quantity and cost, suspicions of corruption and public funds fraud, and the institutions' reduced or inexistent performance. All these aspects point to the need to implement a mechanism in order to assure stakeholders about the effectiveness, credibility and sustainability of public sector institutions.

The objective of the current research is to build an assessment model for the corporate governance in the public sector. We believe that this approach will identify some real gaps in the public sector governance in Romania and it will contribute to the development of a corporate governance culture, through the development and implementation of a code of governance, either voluntarily or by regulation.

The article is structured as it follows: the first section is dedicated to the literature review on corporate governance, and it is followed by a section describing the research methodology. The following section includes the research results; the paper ends with the conclusions section.

1. Research methodology

The conducted research is qualitative in nature. Thus, approaches and dimensions of corporate governance concept were presented, both in the private and public sectors, in relation to the national and international specialized literature. They were complemented by the development of a model for the assessment of governance in the public sector, given the particularities of the institutions within this sector.

2. Conceptual approaches of corporate governance

From a conceptual point of view, the agency theory (Jensen and Meckling, 1976) had an important impact on the corporate governance in the private sector. In the specialized literature, the concept of governance was approached from multiple perspectives. Having as a premise the contractual relationships underlying the functioning of an entity, Jensen and Meckling (1976) believe that the relationship between shareholders (principal) and entity's managers (agent) is generating conflicts because of the divergent interests they may have. Thus, corporate governance is the interface which, through its mechanisms, mitigates the information asymmetry between the principal and the agent. The role of corporate governance is to promote ethical behavior and transparency, to stabilize the balance of power between the shareholders, directors and management, to prevent fraud and improve the confidence entrusted by people and society to the business environment (Matei and Drumaşu, 2014).

From a different perspective, corporate governance refers to the way companies are managed and controlled (The Committee on the Financial Aspects of Corporate Governance, 1992). Corporate governance is a set of structures, rules, procedures and mechanisms for managing and controlling an organization (Yapa, 2014). From another perspective, corporate governance is a system of internal and external entities' examinations, ensuring that they fulfill their responsibility towards all stakeholders and act in a responsible manner in all the areas of their businesses (Sison, 2008).

In terms of the typology of corporate governance mechanisms, Charreaux (1994) identified two categories, namely external and internal mechanisms. External mechanisms are the goods and services market, the banking and financial services market, the labor market, the legal, political and regulatory environments. Internal mechanisms include the control exercised by the shareholders, the mutual supervision among leaders, the formal and informal control implemented by the subordinate employees and board of directors.

In terms of effectiveness, a governance system is effective if the level of satisfaction of an interested party can only be improved by reducing the level of satisfaction of another (Charreaux, 1996). Pitseys (2010) believes that good corporate governance has allowed for the first time a different model for the entity's human resources management.

In terms of the principles of corporate governance, the following were identified in the specialized literature: company openness and information dissemination in order to improve the level of trust; integrity (of the financial statements and people); ethical values; responsibility; competencies/skills; transparency; risk assessment and management; internal control; communication; monitoring; regulatory compliance; segregation of responsibilities; protection of shareholders' rights and their equal treatment; encouraging cooperation between the company and the stakeholders; providing reliable and timely information etc. (Matei and Drumaşu, 2015).

In Romania, corporate governance in the private sector was conceptually outlined and normalized in the year 2000 for the private sector. In 2001 the first code of corporate governance was adopted. The implementation of corporate governance was a difficult attempt, considering the following obstacles (Feleagă, 2008):

- "The absence of detailed analysis concerning the relationship between owners and managers;
- Weak involvement of other parties participating in the decision-making processes;
- Lack of a conceptual framework for an efficient market and its societal implications;
- Questionable involvement of auditors in promoting corporate governance;
- Failure of reforms to implement an accounting system in line with the international developments;
- The weakness of the control mechanisms for sincere, relevant, reliable, comprehensive, comparable and meaningful financial information".

Studies in the specialized literature regarding the development level of corporate governance in Romania revealed that most companies listed on the Bucharest Stock Exchange do not meet the recommendations of the governance code regarding the independence of directors and members of the audit committee, and their degree of transparency it is much lower than that of other European companies (Feleagă et al., 2011). From the perspective of the relationship between corporate entrepreneurship and corporate governance, the results of research on nonfinancial companies listed on the Bucharest Stock Exchange showed that corporate governance promotes entrepreneurship in Romanian companies (Albu and Mateescu, 2014).

Unlike the private sector, the conceptual nuances about corporate governance in the public sector are relatively limited at the international level. However, the international literature offers a portfolio of exhaustive approaches, comparative and multidimensional, on which we rely in our research.

From the perspective of governance in the public sector versus the private sector, Yapa (2014) defines the specific coordinates of the two sectors and argues that in the public sector citizens or their representatives may monitor the use of resources, and the information about public institutions should be disseminated widely in order to substantiate the decision-making processes.

Governance mechanisms in the public sector include (Almquist et al., 2013):

- Structure, which provides clarification of responsibilities;
- Approaches for improving the skills to fulfill duties; and
- Tools such as internal control and external accountability.

Grant et al. (2007) include among the elements of governance: direction setting, strategic alignment, risk management, performance management, control and compliance, relationship management, management of changes and value management.

Mutiganda (2013) developed three governance policies: coercive governance, performance-oriented governance and governance for the mission. Coercive governance monitors compliance with rules and regulations. Performance-oriented governance focuses on results and monitors accountability through quantitative and non-quantitative data. Governance for the mission envisages fulfilling objectives without making a profit.

From the perspective of good governance, Mandeli (2016) developed the following specific standards: transparency, accountability, participation, responsiveness, efficiency in public resource management, audit, law enforcement, disclosure and efficiency. The study of Mandeli (2016) also reveals that information transparency would increase the accountability of public officials and therefore would lead to the enforcement of laws and decrease in corruption. A similar idea is supported by Sukmadilaga et al. (2015), who mention the criteria for good governance in the public sector: participation, respect for the law, transparency, responsiveness, consensus orientation, equity, efficiency and effectiveness, accountability and strategic vision. Good corporate governance reduces the risk of low performance (Edwards and Clough, 2005).

Almquist et al. (2013) argue that for an effective system of governance it is important to establish the appropriate performance measurement tools to provide internal and external stakeholders with the relevant information they need and the assurance that the supplied financial and nonfinancial information is accurate through internal and external audit and also through the hiring of persons with appropriate knowledge and experience in leadership and control.

In Romania, the approaches on corporate governance in the public sector are limited. In terms of the perspective of public healthcare system, empirical research shows that at the level of the national bodies within the European Union countries, the information provided to the public on corporate governance is extremely limited. The only countries that exhibit concerns in this direction are the UK and Ireland. Most official websites of institutions in the public healthcare sector provide information about the organizational structure, leadership and responsibilities of the institution concerned (Germany, Belgium, Bulgaria, Cyprus, Denmark, Finland, Greece, Hungary, Latvia, Lithuania, Malta, Netherlands, Poland Sweden, Czech Republic and Romania), and in some countries (Cyprus, Finland, Latvia and Romania) the existence of an internal audit department within the investigated institutions was found (Ştefănescu et al., 2012).

Also, studies on the transparency of financial information for the central public administration and public hospitals under the Ministry of Health revealed a significant limitation thereof (Ştefănescu and Ţurlea, 2013; 2014).

In the context of promoting transparency in the public sector, Nistor and Deaconu (2014) believe that the *e*-governance system facilitates the interaction between public institutions and people, simplifies bureaucratic procedures, provides information and improves transparency. Among the information that should be included are: regulations about the organization and functioning of public institutions, organizational charts, financial statements, budgets, procurement documents, program, ongoing projects, contact information and the possibility to translate the information in at least one foreign language.

For the Romanian lawmakers, concerns for the development of a referential dedicated to corporate governance in the public sector are missing or are in a project stage. Currently, the issues are covered by default by applying a legislative portfolio issued by the authorities. At the opposite pole there are the public enterprises, for which there is a clear regulatory framework (Law no. 111/2016).

The research carried out shows that the presented conceptual approaches converge to corporate governance mechanisms, the need for good governance, its coordinates and impact, as well as the relationship between corporate governance and performance.

3. Assessment of corporate governance in the Romanian public sector

The approach of developing a model for the assessment of corporate governance in the public sector is based on the ideas presented as a result of the literature review and on the specific mechanism of public institutions' organization and functioning.

The proposed model for the assessment of corporate governance in the public sector is structured on five criteria, tailored to the specificities of the public sector institutions: organization, activity, control/supervision, financial and nonfinancial reporting, transparency (see Table 1). Each criterion is rated on a scale from 0 to 100 points, based on the degree of achievement, and represents 20 percent of the total score.

In analyzing compliance with the criteria that define good governance for public sector entities in terms of *organization,* the following coordinates will be considered: structure, regulations, objectives and strategies, integrity. *Structure* refers to elements that define the public institution: organizational chart's availability on the institution's website, the publication or availability of information relating to the existing departments within the public institution and their managers, the disclosure of information about the management team and the board members, published contact information and working hours, along with other information regarding the organization of the public institution, that may be relevant to the stakeholders. In terms of *regulations,* for an effective system of governance we believe that there should be considered the disclosure of information and documents such as: the public institution's organization and functioning regulations, regulations and internal procedures specific to the public institution's activity, information regarding the board of directors, including procedures for appointing its members, the members of the board, together with their roles and responsibilities, as any other information useful to the general public. In order to provide the stakeholders with trust about the sustainability of the institution and, by consequence, about its services, it is mandatory to provide information on the institution's *objectives and strategies*, including: general objectives of the public institution, the development strategy etc. Also, good governance should be based on the principles of *integrity*. Integrity confirmation can be promoted through: the adoption and publication of a code of ethics, publication of declarations of assets and interests, providing information on the monthly salary of the management team and board of directors' members, the existence of a board of ethics, the disclosure of information about the ethics board's composition and information on its activities, declarations of incompatibility and conflicts of interests.

Table 1. Model for the evaluation of corporate governance in the public sector

No.	Evaluation criteria		Score	%
1.	**Organization**	➢ Structure ➢ Regulations ➢ Objectives and strategies ➢ Integrity	0-100	20
2.	**Activity**	➢ Services ➢ Public acquisitions ➢ Logistics ➢ Human resources ➢ Projects	0-100	20
3.	**Control/supervision**	➢ Internal/managerial control ➢ Internal audit ➢ Financial audit	0-100	20
4.	**Financial and nonfinancial reporting**	➢ Budget ➢ Financial statements ➢ Reports disclosing financial and nonfinancial performance	0-100	20
5.	**Transparency**	➢ Website ➢ Relations with stakeholders	0-100	20
	TOTAL		**X**	**100**

Source: Authors' processing.

The second criterion for assessing corporate governance in public sector is *activity,* which includes the following elements: services, public acquisitions, logistics, human resources, projects. The *services* offered by the public institutions can aggravate conflictual relationship between the institutions and the stakeholders. Given the downward trend of public resources with a negative impact on the supply – demand ratio for public services and also on the value for cost ratio, good governance requires continuous notification of stakeholders about the full details of the offer of free and paid services. Also, good governance involves credibility regarding the efficient management of public resources. As *public acquisitions* are a vulnerable component in the public sector, we believe that, in order to eliminate suspicions regarding the use of public resources, stakeholders should be informed of the annual procurement plan and its degree of realization, the monthly value of purchases and their nature, data about the suppliers of goods and services. In order to support stakeholders' decision making processes, the institution should provide information on *logistics* or the existing facilities used for the rendering of public services. As *human resources* play an important role in the public sector, the stakeholders may be potential employees, and the institution should ensure the transparency of the recruitment process. Last but not least, good governance requires a realistic perspective by informing stakeholders about the ongoing and completed *projects*.

The fourth criterion for assessing corporate governance in the public sector is *control/supervision*, including the following directions: *internal control/managerial internal control*, risk management, internal audit, and financial audit. Given the managerial function carried out by the *internal control/managerial internal control*, the disclosure of its existence and responsibilities assures stakeholders with regard to: the economic, efficient and effective administration of the public resources; the reliability of internal and external information; compliance with regulations, internal policies and procedures of public institutions. Additionally, in order to provide information to stakeholders in an objective and independent manner about the control of operations, about the efficient and effective public revenues and expenditures, about objectives' fulfilment by means of evaluating the processes of risk management, control and governance inside the institution, stakeholders must also be informed of the details about the *internal audit*. From this perspective, public institutions must disclose the structure of the internal audit committee, its responsibilities and the schedule of the meetings. Since the existence of an internal audit committee within public institutions is limited to meeting certain criteria, in the absence of such a committee the institutions will disclose information about the internal audit department. Institution's credibility, as it is perceived by the stakeholders is enhanced by the *financial audit* performed by the Romanian Court of Accounts. The dissemination of the financial audit reports will inform stakeholders about the true and fair view of the information presented in the financial statements, the irregularities found, and the measures to be taken to eliminate irregularities.

Financial and nonfinancial reporting also contributes to the mitigation of the information asymmetry between the public institution's management and the stakeholders. The variety of the stakeholders in the public sector, together with their importance determines, for good governance, the necessity to publicly disclose the budget, the financial statements and the reports on financial and nonfinancial performance. To reliably support the set objectives, the institution must provide interested parties with information on the resources allocated and their respective destination, in accordance to the approved *budget*. Based on the full set of quarterly reports and annual *financial statements*, stakeholders are informed in a manner that is understandable, relevant, reliable and comparable about the public institution's financial position, financial performance and cash flows. In addition, the publication of *reports on financial and nonfinancial performance* informs stakeholders on how the institution has acquired the resources and whether it used them economically, efficiently and effectively to achieve the objectives in their best interest, and, respectively, on the institution's degree of involvement in economic, social and environmental activities.

The fifth criterion of analysis of corporate governance in the public sector, *transparency*, has two dimensions, namely the website and the relations with stakeholders. The institution's *website* is the fastest way to disseminate reliable and timely information to stakeholders. From this perspective, good governance must consider the following aspects: permanent website availability, easy navigation, publishing of timely and relevant information, continuous update of the information, the translation of website information in a foreign language. *Relations with stakeholders*, either directly or indirectly, assures them about the responsibility that managers of public institutions have assumed.

Conclusions

The research carried out proves that the conceptual approaches regarding corporate governance are varied, but they interfere with regard to the following coordinates: the mechanisms for effective governance, the need for policies specific to good governance, and the correlation between corporate governance and performance. Moreover, investigating corporate governance in the Romanian public sector revealed its limitations, both in terms of its conceptual development and specific regulations. From this perspective, we consider the development of a model for the assessment of governance in the Romanian public sector as a useful item. Structured in five evaluation criteria specific to the organization mechanism for the public sector (activity, control/supervision, financial and nonfinancial reporting and transparency), the model identifies the weak spots of good governance in the public sector and responds to the real information needs of the stakeholders regarding the efficiency and effectiveness of public resources management, accountability, transparency, financial nonfinancial reporting, performance, and sustainability.

We believe that one of the limitations of the current research is the difficulty of implementing the model for the assessment of corporate governance in the public sector at an international level, which affects the comparability of corporate governance. Also, it is known that at an international level, the corporate governance culture is heterogeneous, mainly due to the conceptual and regulatory peculiarities specific to the public sector.

As future research directions, we intend to perform a test of the proposed evaluation model for the assessment of corporate governance in public sector institutions in Romania.

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