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# Corporate Governance in Listed and State- Controlled Companies in the Romanian Energy System

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## Abstract

*Over the time, corporate governance has become a central pawn in the health and strength of the global economy, representing how organizations are run and controlled. But behind this evolution, there were numerous challenges and scandals that marked the economy. This is also the case of Romania, the country where corporate governance emerged after the 2000s, a delay based on various economic, social, but especially political reforms. Things have improved over the time, adhering to governance codes that reflect sufficient transparency that is useful to investors, but also to other stakeholders.*

*The main objective of this research is to analyze the corporate governance in the companies which are listed and controlled by the state, from the Romanian energy system, with the role of identifying certain points that deserve to be improved in the future, so that the users of information can associate the entity with a high degree of transparency. Secondary objectives consist of analyzing other elements such as internal control, ethics, internal audit and external audit, which ultimately have an impact on corporate governance.*

**Keywords:** *corporate governance; energy system; state-controlled companies; unitary model; internal and external audit; ethics*

**JEL Classification:** *G30, H70, M42*

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## Introduction

State capitalism is a popular choice among transition economies, while state-controlled companies have gradually disappeared from developed economies and there has been an extended privatization process in emerging economies (Wooldridge, 2012).

In market economies, state-controlled companies represent the product of state intervention in the market, the latter being a majority shareholder. They operate in different sectors, and the most important industries are energy, transport, utilities, natural resources and infrastructure (OECD, 2005).

Historically, all of these interventions occurred because of the war (World War II), the financial crisis or the economic downturn (Great Depression of the 1930s). It can be assumed that these state interventions can be seen as tools to repair potential or real market failures, the latter meaning the existence of monopolies (for example, energy or railways), but not limited to them (Bouchez, 2008).

Currently, there are many cases where at least one government institution exists in a governance structure within a state-controlled society. Governance can be assimilated to an umbrella term, as it includes different meanings and perceptions, being used both in economics and in political and management sciences. In modern social sciences, "governance" has become one of the popular terms, dealing with the direction and coordination of different actors in network-type collaboration models (Almquist, 2012).

Various companies, as well as regulatory institutions, have endeavored to model corporate governance systems that guarantee investor rights and all these efforts have, in fact, been motivated by the importance of corporate governance for investors (Crisostomo and Brandao, 2019).

A very well-established fact regarding corporate property rights is that the ownership of large listed entities, in the United Kingdom (UK) and the United States (US), is dispersed, while in most other countries it is concentrated (Franks, Mayer and Rossi, 2009).

In 1997, the OECD began to focus on the corporate governance of state-controlled companies as part of the activity undertaken by what was later called the OECD privatization network. This program aimed, among others, at developing policy recommendations to

enhance corporate governance in entities where the state is a majority shareholder, considering the choice of methods for post-privatization performance and corporate governance (Bouchez, 2008).

Direct ownership means that the shares held by the state are transferred directly by different authorized government agencies. Indirect ownership is when the state holds the stake through other organizations or through a chain of organizations (Abramov, 2017).

As Bouchez (2008) mentioned, there were different reasons for the privatization programs, the most important being the following: improvement both the efficiency and the performance of the entities controlled by the state, by introducing competition in different sectors considered as monopolies such as utilities, postal services or telecom; foreign investments and the development of capital markets; and different fiscal objectives, which are based on government constraints on the state budget (Bouchez, 2008).

However, the entire analysis of the state property right is complex, due to the fact that a state-controlled company should not be defined as an autonomous entity because, in fact, it is the state that manages the funds belonging to the whole company, the last element representing, in fact, the shareholder even under state ownership (Crisostomo and Brandao, 2019).

In this context, the main objective of the study is to investigate elements of corporate governance applicable in the listed entities and controlled by the Romanian state in order to identify certain points that can be improved in the future, so that there is a degree of much higher transparency.

The contribution made by this study is represented by the detailed analysis performed on the corporate governance structure, the diversity and size of the governing bodies, the degree of independence of the board members, the internal control, the ethics, the internal audit and the external audit, applicable to the entities in which the state is a majority shareholder at the end of 2018.

The article includes the following sections: the first chapter is the review of the literature on state-controlled companies, followed by the research methodology, the research results, then recommendations and recognition.

## 1. Literature review

In recent years, many financial scandals have brought to the fore the lack of transparency and insufficient control systems encountered in certain entities (Roussy, 2013).

The construction of a solid internal control system is a long process, which requires significant efforts made by all the personnel of an organization, especially by the management (Order 600/2018 issued by the General Secretary of the Government).

The management control system is an important component of the organizations, and the efficient internal control systems are able to ensure the fulfillment of the entity's objectives, the same being applied for the state-controlled companies (Leng and Zhang, 2014).

In a study conducted by the OECD in 2018, 90% of state-controlled companies have a risk assessment on integrity and corruption. The results show that those entities that evaluate the risks each year, report fewer compliance risks and consider that their management control and risk management systems are more efficient compared to other state-controlled companies that perform such assessments less regular or not at all (OECD, 2018).

All the failures that led to the bankruptcy of entities over the past two decades have highlighted the fact that internal audit must exist. The internal audit function began to be defined in large companies throughout the world, the frequency of this process being higher after 1940.

Regarding the role in corporate governance, it was observed that the independence and objectivity of the internal audit are ensured through their double reporting line to the audit committee and the supervisory board (Allegrini et al., 2006).

Vanasco (1996) discloses that the role assumed by internal auditors actually implies the "unrestricted" independence required to perform different tasks within entities.

In the public sector, internal auditors play two key roles: a protective role that is further divided into two roles, a secrets keeper and an assisting role (guide and support for organizational performance). First, the protective role reveals the internal auditors that protect, on the one hand, the manager, and on the other, the members of the audit committee against any obstacles or pitfalls that may arise. Second, internal auditors support

organizational performance and provide guidance when a new management strategy or measure is adopted by the entity or when a new administrative rule is implemented (Roussy, 2013).

Van Peurse (2005) observes in a case study based on interviews with internal auditors that the professional statute of the internal auditor has an impact on his / her appearance and influence and also emphasizes that, as a rule, the most important feature in the attainment of an independent statute can be found in the communication. Informal communication modalities have been shown to have the power to influence and these are added to the quality of a formal communication through an active management body or an audit committee, using mechanisms and procedures with the role of assigning a level of official and respected authority to the position of internal auditor.

If authorities want to strengthen the way organizations are run and controlled, then different mechanisms used to ensure better governance, must be seen as part of a whole in order to be able to develop an intelligent network from a variety of mechanisms designed to improve corporate governance of entities in which the state is a majority shareholder (Roussy, 2013).

The audit committee is a key player that can ensure an efficient internal audit function, being an important component of an organization. The audit committee is primarily concerned with the activities of the internal auditors and, in particular, with the implementation of their recommendations.

The OECD recommends the following: "The governing bodies of state-controlled companies should consider setting up specialized committees, composed of independent and qualified members, to assist the board of directors in performing its functions, in particular in regards to auditing, risk management and remuneration". An OECD study shows that 84% of respondents mentioned the existence of an audit committee within the entity in which the state is a majority shareholder, making it the most common specialized committee (OECD, 2018).

The financial experience of the audit committee is a crucial aspect of monitoring the quality of financial reporting (SEC, 2003).

In the case of state-controlled companies, it is important that the members of the audit committee do not pursue their political interests through the audit process,

controlling the areas that have been chosen to be audited, even if they are tempted to exercise political influence in some cases (Thomasson, 2018).

Regarding the audit performed by a statutory auditor, in most OECD countries, the state-controlled companies are usually subject to the same requirements. According to the International Auditing Standard 200, within the framework of an audit of financial statements, the statutory auditor has two general objectives, namely: obtaining reasonable assurance as to the extent to which the financial statements as a whole do not contain significant distortions, either as a result of fraud or errors, thus allowing the auditor to express an opinion on the extent to which the financial statements are prepared, in all material respects, in accordance with a financial reporting framework applicable to the entity; and reporting on the financial statements and reporting the findings in accordance with International Auditing Standards.

In addition, external audits represent an important incentive for the executive management and boards of directors of state-controlled companies, their results being taken into account by the shareholders and other stakeholders (OECD, 2005).

In conducting external audits, the selection of the independent auditor is important. Typically, hiring large accounting firms may depend on the level of corporate governance applied in each entity. If the entities in which the state is a majority shareholder have good corporate governance but at the same time have a high concern for improving the way they are managed and controlled, then a prestigious multinational might be preferred (Lin & Liu 2009 and Houque et al 2015).

The selection of the external auditor is a common function of the audit committee, along with reviewing the audit results and verifying the financial statements.

At the same time, auditors with a lower notoriety in the market are usually preferred by entities with a weak corporate governance mechanism, these having "opaque" gains that need to be protected. The same study shows that the effectiveness of the audit monitoring process is positively affected by the corporate governance practices of state-controlled companies in China (Lin and Liu, 2009).

In addition, the results mentioned above suggest that BIG 4 auditors, in the emerging market, have a role in corporate governance.

Worldwide, in establishing the procedures needed to improve the quality of financial statements, corporate governance codes have emphasized the role of external auditors in ensuring that the figures reported as revenue reflect accurate information about the entity's operations and reducing revenue handled in an opportunistic manner (Young, 2000).

If emerging markets are compared to the US or the UK, their external auditors may play a role in corporate governance which is more significant and this is due to conventional corporate control systems that are often inadequate in protecting external investors (Ghosh, 2011).

## 2. Research methodology

### 2.1. Object of the study: Defining the objectives and the research methodology

The main objective of this study is to investigate the corporate governance structure existing in listed entities in which the Romanian state is a majority shareholder, including the declaration of compliance with the provisions of the corporate governance code of the Bucharest Stock Exchange.

As a secondary objective, aspects regarding the external audit, the internal audit, the relationship between them, as well as some details related to the financial performance of each entity will be analyzed.

First, the results of the present study will highlight the composition of the governing bodies within the entities in which the state is a majority shareholder, as well as the volatility of the mandates of their members, which highlights the stability of the Romanian energy system.

Secondly, the analysis of the internal and external audit missions, the applicable ethical code, as well as the information on internal control, will show, on the one hand, the transparency of the entity in relation to the other stakeholders, and on the other hand demonstrate a direct link between the aforementioned components and the stability of the management structures within the analyzed entities, which subsequently has an impact on financial performance.

Regarding the research methodology, the methods used are content analysis and comparative analysis, with a qualitative approach through a coding process applied to

the annual reports, respectively to the financial statements of the entities. The coding process was performed manually.

The first stage of the content and comparative analysis is the review of the annual reports of the entities of the selected entities, in order to identify data on the corporate governance structures encountered, as well as the points mentioned in the declaration of conformity as being not respected, explaining the reason.

The second stage is the identification of the existence of an internal control system and a code of ethics, and if data are presented, mention of significant aspects thereof; analysis of internal audit missions if they are included in public reports; as well as the analysis of the independent auditor's report along with the key audit issues identified.

## 2.2. Sample presentation

The population, as of December 31, 2018, consists of the total number of 29 economic operators that are included in the portfolio of the Ministry of Energy, out of which: two national entities; four national companies, two autonomous companies and 21 economic operators, respectively, organized as joint stock companies.

According to the Ministry of Energy (ME), the 21 economic operators are grouped according to the weight held by ME, on behalf of the state, as follows: ME – sole shareholder in a number of 11 economic operators, ME holds the majority shareholder share in a number of 9 economic operators, and finally, it is a minority shareholder to a number of 7 economic operators.

It is important to remember that the Bucharest Stock Exchange is one of the most significant institutions of the entities, so we will pay more attention to the listed companies, especially where the state is the majority shareholder. We chose this in order to be able to identify certain behaviors of the Romanian state in relation to corporate governance, but also because the trading on the stock market ensures the possibility for more private investors to participate in the decision-making and management of the entities, significantly improving the efficiency of their operations, through the interest of minority investors, thus resulting in a transparency of the decision-making act and an increase of investor confidence.

We decided to select all those entities listed on the stock exchange, in which the state owns a majority capital,

more exactly exceeding 50% of the total, but also the companies that the state controls, as of December 31, 2018. The state is a minority shareholder, or majority through ME in a total number of 7 entities, holding a minority stake in OMV Petrom SA, Rompetrol Rafinare SA and Electrica. However, within Electrica, the state owns 48.78% of the capital, in fact getting to control this entity.

Therefore, the companies that will be the subject of the present case study are the following: Conpet SA, SN Nuclearelectrica SA, Oil Terminal, SNGN Romgaz SA and Electrica. The analysis period is considered to be the financial year ended December 31, 2018.

## 2.3. Data collection and model description

The data source is represented by the public information existing in the annual reports, the financial statements, the reports of the independent auditor and any other reports if necessary, related to the entities in the selected sample.

The input data to be analyzed are related to: financial performance, the applicable corporate governance model, the structure of the board of directors, including its size and the frequency of meetings if mentioned, the existence of advisory committees and their composition, the shareholding structure, the main aspects regarding ethics, as well as internal control and internal audit.

Regarding the information on the external audit, these mainly refer to the auditor's membership in BIG 4, respectively the type of opinion issued, as well as to the period for which audit activities were carried out. For key audit issues, we focused on identifying and analyzing them in terms of number and nature.

## 3. Results and discussions

### 3.1. General data and financial performance

While the National Company Nuclearelectrica SA (SNN), established in 1998 as a result of the restructuring of the Romanian energy system, is the only producer of electricity based on nuclear technology in Romania, the National Company of Natural Gases "ROMGAZ" SA is the most important producer and supplier of natural gas from Romania, having more than one hundred years experience in the field of natural gas exploration and exploitation with a history that began in 1909. Thus, the

two companies complement each other, being two significant players in Romania. Electrica deals with the regulated distribution of electricity and its supply to final consumers.

The flow is completed by the company Oil Terminal SA, which is the largest operator of petroleum products in the port of Constanța whose object of activity includes the provision of services regarding the receipt, loading, unloading, storage and conditioning of oil, petroleum, petrochemical and liquid chemical products for import, export and transit.

An important stage in this energy process is also the transportation of crude oil through pipes, Conpet SA holding a monopoly position on the Romanian market, operating, safely, the National Petroleum Transport System through pipes.

From the point of view of financial performance, the following indicators were analyzed: turnover, EBITDA and net profit. EBITDA represents the profit of a company before interest, depreciation and amortization. The results highlighted in **Table no. 1** shows that Romgaz is the most profitable entity in our sample, registering a 24.3% decrease in net profit, in 2018 compared to 2017, net profit representing 66.1% in the total net profit of the selected companies. The only increase in the level of net profit is recorded by SNN, with 33.9%, but this entity has a smaller share, of 19.9%, in total.

Regarding the turnover, a significant weight is represented by Electrica, 42.3% in the total related to the sample, followed by Romgaz, with a weight of 37.7%, registering a growth of 0.2% within the first company, followed by the second one with an increase of 9.1%.

<b>Table no. 1. Financial performance</b>				
Turnover	RON Thousands		Variance 2018 versus 2017 (%)	Weight in total – 2018 (%)
	Company	2018		
SNN	2,129,745	1,899,936	12.1%	16.0%
Romgaz	5,004,200	4,585,200	9.1%	37.7%
Oil Terminal SA	146,000	158,000	-7.6%	1.1%
Conpet SA	385,140	376,690	2.2%	2.9%
Electrica	5613000	5603000	0.2%	42.3%
<b>Total</b>	<b>13,278,085</b>	<b>12,622,826</b>	<b>5.2%</b>	<b>100%</b>
<b>Net profit</b>				
RON Thousands				
SNN	410,611	306,543	33.9%	19.9%
Romgaz	1,366,200	1,803,600	-24.3%	66.1%
Oil Terminal SA	280	5,000	-94.4%	0.0%
Conpet SA	60,680	74,390	-18.4%	2.9%
Electrica	230,000	128,000	79.7%	11%
<b>Total</b>	<b>2,067,771</b>	<b>2,317,533</b>	<b>-11%</b>	<b>100%</b>
<b>EBITDA</b>				
RON Thousands				
SNN	1,089,505	923,794	17.9%	26.3%
Romgaz	2,240,000	2,405,500	-6.9%	54.1%
Oil Terminal SA	18,500	9,500	94.7%	0.4%
Conpet SA	110,740	127,560	-13.2%	2.7%
Electrica	681,000	601,000	13.3%	16.5%
<b>Total</b>	<b>4,139,745</b>	<b>4,067,354</b>	<b>2%</b>	<b>100%</b>

Source: Authors analysis

### 3.2. Ownership structure

For the five selected entities, we analyzed the distribution of the share capital from the point of view of the type of shareholder, including them in one of three categories, namely: the Romanian state, legal entities and individual persons.

In the **Table no. 2** is presented the percentage held by the Romanian state in the share capital in each of the selected entities and, at the same time, in the case of Electrica, where, in fact, the ME can control the company even though it owns less than 50% of its share capital, in the situation in which the individual persons owning about 5.4% of the total capital of the entity, would sell ME some of the shares.

**Table no. 2. The capital held by the Romanian state in the selected companies**

Company	% of share capital as of 31 December 2018
SNN	82.50%
Romgaz	70.01%
Oil Terminal SA	59.62%
Conpet SA	58.72%
Electrica	48.78%

Source: Authors analysis

In the **Table no. 3**, it can be observed that the share of capital held by legal entities is noted in the case of Electrica, 45.83%, of which the European Bank for Reconstruction and Development owns 6.9% in total capital, followed by Dedeman SRL with a number of shares between 5 and 10% in total.

At the same time, Dedeman SRL owns 7.41% of the total capital of Conpet SA, representing about a quarter of the shares held by legal entities.

In the case of SNN, Fondul Proprietatea SA holds 7.05% of the total capital, meaning over half of the shares held by legal entities.

**Table no. 3. The capital held by legal entities**

Company	% of share capital as of 31 December 2018
SNN	12.70%
Romgaz	25.43%
Oil Terminal SA	10.42%
Conpet SA	28.67%
Electrica	45.83%

Source: Authors analysis

As expected, individuals hold a significantly smaller number of shares (**Table no. 4**), only in a single entity having a higher share compared to the other analyzed

entities. However, in Oil Terminal SA, out of 29.96%, one individual owns 15.59% of the total number of 582.4 million shares.

**Table no. 4. The capital held by individuals**

Company	% of share capital as of 31 December 2018
SNN	4.80%
Romgaz	4.57%
Oil Terminal SA	29.96%
Conpet SA	12.62%
Electrica	5.39%

Source: Authors analysis

### 3.3. Board of Directors

Among the many roles of the board of directors (BoD), there is also that of overseeing the fulfillment of the organization's objectives. The corporate governance code of the Bucharest Stock Exchange ("BSE") specifies that a number of at least five members should be part of the BoD. Therefore, we analyzed this management body

from the perspective of several aspects such as: size, internationalization, diversity, age, mandate and related interim period, number of meetings per year and / or their frequency.

Regarding the size of the BoD, all the five entities analyzed have a number of 7 members, the data being analyzed as of December 31, 2018, with the exception

of Electrica, for which the data were taken from the information updated at the date of the publication of the 2018 annual report. This aspect demonstrates homogeneity within the companies controlled by the Romanian state and, at the same time, compliance with the legal requirements, in this case being the odd number of directors, according to the Companies Law (Companies Law no. 31/1990).

The results show that for 4 out of 5 entities analyzed, the BoD is made up only of Romanian citizens, only in the case of Romgaz, there being only one citizen with foreign nationality.

Regarding gender diversity, in the case of Conpet SA there is no woman to hold a position in the BoD, while in Romgaz there are two, the rest of the companies having all one female member. It is important to mention that the female person who is part of the BoD of Romgaz is also a member of the BoD in Electrica and Oil Terminal.

Regarding independence, for 3 out of 5 entities, the BoD members are totally non-executive, while in the case of SNN and Romgaz, the share of the executive members in total BoD members is 14%, which is insignificant.

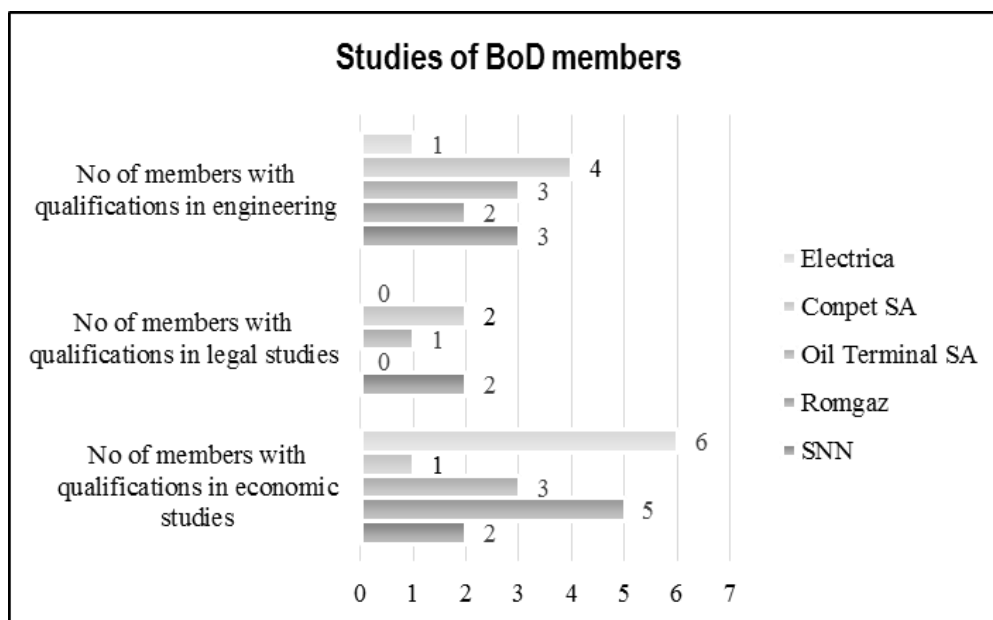
In all the companies analyzed, the period of the mandate is four years. Also, in 3 out of 5 entities there were

changes regarding the mandate of the members of the BoD, being taken into consideration interim periods, or resignations, respectively new appointments. For two other companies, analyzing the data sources, it was not mentioned whether there were persons with interim mandates. However, based on this analysis, we can argue that, in terms of size and structure, the BoD is a stable one, not being influenced by a large or unusual rotation.

In the case of Romgaz, the frequency of BoD meetings and their number are not specified. In the case of SNN, there were 45 meetings, followed by Oil Terminal with 31, then Electrica with 22, and finally the quarterly and / or ad-hoc meetings of the Conpet case.

Regarding the field in which the members of the BoD are licensed, the results show that in the case of Electrica, 86% of the members of the BoD are active in the economic field, while in the other entities, the specializations are divided as belonging to the field of engineering, legal or economic. Only in the case of Romgaz has it been observed that there is no member in the BoD that monitors the entire activity related to legal aspects (*Chart no. 1*).

**Chart no. 1. Studies of BoD members**



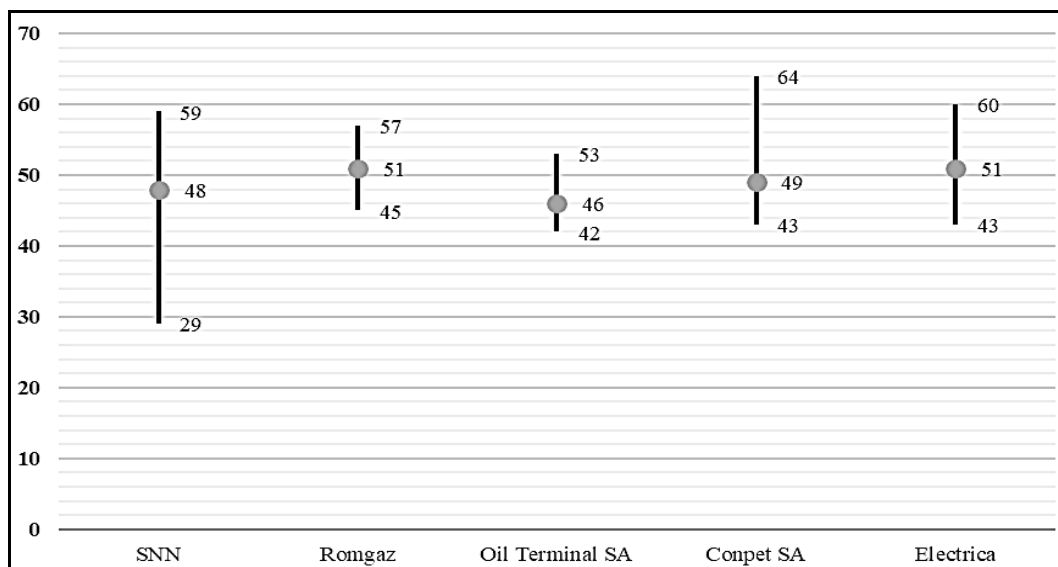
Source: Authors analysis



Regarding the age of the members of the BoD, in the **Chart no. 2** the following can be observed: minimum age, maximum age, but also average age. However, there are some situations in which data were not

collected, because they were not available to the public, and in this situation, they were not taken in the sample nor in the calculation of the average age, thus limiting the results obtained.

**Chart no. 2. Age of BoD members**



Source: Authors analysis

### 3.4. Executive Committee

The analysis of the composition of the executive committee of the selected companies demonstrates a greater volatility within the mandates, the analyzed year being one with sufficient changes that will be described later in the study.

Although the Companies Law (Companies Law no. 31/1990) provides that the executive committee must always include an odd number of members, we note that for 3 of the 5 entities analyzed, the number is even, either of 2 members as is the case of Romgaz, or 6 for SNN and Oil Terminal SA. Conpet SA has 3 members in the executive management, while Electrica has 7.

It is noteworthy that all the 5 companies analyzed have in the executive management only members of Romanian nationality, confirming that the Romanian state, being a majority shareholder in 4 of the 5 entities, is actively involved in the nomination of the persons designated to lead the activities needed to meet strategic objectives.

In terms of diversity, in SNN and Romgaz it is observed that no woman holds a management position, while in Oil Terminal two women hold executive positions out of four directors, as well as in Conpet, two executive positions out of three being occupied by female persons.

The professional training of the members of the executive management is oriented towards the economic studies, followed by those in the engineering and legal fields, the latter being met only in the case of Oil Terminal SA and Conpet SA.

At the same time, we note that Oil Terminal, Romgaz and Electrica have not experienced changes, other than those related to the expiration of the mandate, in the members of the executive management and this reflects stability. As for SNN, it is worth mentioning that it has the youngest general manager in this position, if we refer to all the companies analyzed. However, it had four interim mandates during 2018, and these interim periods are applicable also to the financial director, respectively to the deputy general manager. Also, the mandate expired at the end of the year 2018 for the branch directors from

Cernavoda, respectively Pitești. All of these things can transmit instability to other stakeholders.

In Conpet SA, things are similar to SNN, in the sense that during 2018 there are changes, and especially restructuring, from six director positions, there are only three at the end of the year, the positions of deputy director 2, transport operations and development of maintenance being canceled. During the year 2018, there were four interim periods for the general manager, but also economic director, which may also represent a rather high volatility that may threaten to fulfill the strategic objectives of the entity.

### 3.5. Advisory committees

The more the board of directors is made up of more members, the more difficult it will be to cope with the workload, so that the activity of the members of the BoD is allocated to several advisory committees.

In relation to the size of the BoD, the advisory committees of each entity from the sample were analyzed. In 4 of the 5 companies analyzed, the size of the BoD is directly proportional to the number of advisory committees, three committees reported to seven members of the BoD, except SNN, where there are 4 advisory committees.

All entities have the audit committee (and risk in the case of Electrica) and the nomination and remuneration committee. In addition, 4 out of 5 entities that have three advisory committees also include a strategy and development committee, which is distinctly named in each of the companies, but fulfills the same tasks. In the case of SNN, there is a strategy committee, but in addition, the fourth one is represented by the advisory committee for nuclear safety, specific to the activity.

During 2018, in Conpet SA, the financial and for the relationship with investors committee and the development and for the relationship with the authorities committee joined, becoming the development and for the relationship with investors and authorities committee.

It is worth mentioning that in 2 of the 5 entities analyzed, Oil Terminal SA and Electrica, the chairman of the audit committee is a woman, which supports gender diversity in key positions. Regarding the number of members of the audit committee, for Romgaz and Conpet there are 6-7, and for all the others the number is constant, of 3 members. All members of the audit committees are independent.

### 3.6. Declaration of conformity

The BSE corporate governance code represents a set of principles and recommendations for listed companies, the purpose being to create an attractive capital market internationally, based on transparency, best practices and trust.

BSE is the one that maintains a mechanism that is based on the "apply or explain" principle, through which the transfer of information in the market takes place, clear, current and accurate regarding compliance with corporate governance rules.

According to the governance code published by BSE, there are a total of 34 principles that it adheres to. Electrica is the only company that presents all 34 principles as being fully respected.

The principle related to evaluation policy / guide of the council that includes the purpose, criteria and frequency of the evaluation (A.8.) is not respected in 3 of 5 entities analyzed. SNN argues that there is no such policy at the moment, but will be implemented after the elections of the BoD with a 4-year mandate. Conpet does not respect the principle related to the above-mentioned policy, same as Romgaz, but the latter entity approved on March 12, 2019 the policy regarding the evaluation of the BoD.

Six other principles were not respected but explained, among which four of the six are related to the Oil Terminal entity.

### 3.7. Internal control and ethics

The system of internal managerial control has the role to prevent errors and irregularities, to preventively eliminate the causes that determine them and to improve the controlled activities. It has been identified and analyzed in all five companies analyzed.

In SNN, having one of the most complex internal control environments in the operational area, the organizational culture is directed to a continuous improvement so that the supervision of all the essential points can be ensured. Three lines of defense are described, the first being represented by the operational controls and the financial preventive ones; the second aims at ensuring that the first line of defense functions properly, including controls related to risk management, security and information protection, critical infrastructure; the third line of defense is represented by the internal public audit which has the role of evaluating the other two lines of

defense. At the same time, the analysis of the risk factors at the macroeconomic and operational level is presented. There are 7 risks, four of which have a strong impact, but for all these have been identified and presented mitigation methods, which expresses a high degree of transparency.

Romgaz does not present enough information about its internal control system, but only that it exists and operates in an ever-changing control environment.

At the end of 2018, Oil Terminal SA reported 102 risks, out of which one risk with a high impact and 10 risks with a medium impact, representing 10,78% of the total identified risks. However, Oil Terminal SA does not describe what the actions were to reduce these risks.

Conpet SA presents a number of 173 risks classified on each of the 11 risk management teams, out of which 42 are reported within the maintenance management team. Out of the total risks, 6% have a low degree of acceptability and 39% have a high degree of acceptability.

Electrica presents the main activities carried out on internal control, and in the annex to the governance code, it lists the three policies governing this activity. However, no information is provided regarding the number of

identified risks, their classification according to probability and impact or the measures to reduce them.

In 3 out of 5 entities analyzed, the existence of a monitoring commission is specified which has the role of coordinating, supervising and methodologically guiding the implementation and development of the internal management control system, supported by risk management teams. Romgaz and Electrica do not clearly state the existence of this monitoring commission.

The code of ethics is present in all the companies analyzed. We performed an analysis of the ethical principles at the level of each entity, and the results are highlighted in **Table no. 5**. All 5 companies analyzed mentioned in the code of ethics principles such as integrity and non-discrimination, the two together accounting for 23% of the total ethical principles identified through comparative analysis.

Professionalism is an ethical principle mentioned by all the entities in the sample, except Electrica. However, Electrica is the only company that includes innovation and fair competition as ethical principles. Performance, quality of services and credibility are the principles listed by a single entity, Oil Terminal SA.

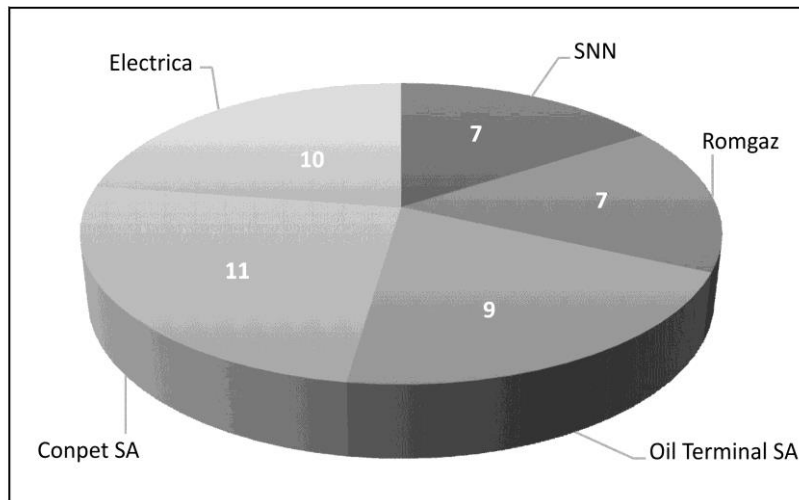
Ethical principles	No of ethical principles	% in total
Integrity	5	11%
Non-discrimination	5	11%
Professionalism	4	9%
Loyalty	3	7%
Respect / Courtesy	3	7%
Freedom of thought and expression	3	7%
Social responsibility	2	5%
Responsibility	2	5%
Objectivity	2	5%
Transparency	2	5%
Priority of the society interest	2	5%
Honesty and fairness	2	5%
Behaviour / Legal behaviour	2	5%
Respecting the rule of law / legality	2	5%
Innovation	1	2%
Loyal competition	1	2%
Performance	1	2%
Service quality	1	2%
Credibility	1	2%
<b>Total</b>	<b>44</b>	<b>100%</b>

Source: Authors analysis

From the point of view of the number of ethical principles reported, the situation at entity level is presented in the **Chart no. 3**. As it can be

observed, most of the principles are listed at the level of Conpet SA, followed by Electrica.

**Chart no. 3. Number of ethical principles reported at company level**



Source: Authors analysis

### 3.8. Internal audit and external audit

All the analyzed entities have an internal audit department that carries out assurance and advisory missions according to the internal audit plan, respectively ad-hoc missions required by management.

Following the analysis of the information presented regarding the internal audit, in terms of the number of audit missions carried out in 2018, Oil Terminal does not present any information, while in Conpet there were 8 missions, in Electrica – 7, and in SNA and Romgaz – 6 missions.

The split of the audit missions between those that take place according to the internal audit plan and the ad-hoc ones is done only in the case of three out of five companies analyzed, namely Romgaz SA had 4 ad-hoc missions and 2 according to the internal audit plan, SNN had 2 ad-hoc missions and 4 missions according to the plan, and Conpet reported 2 ad-hoc missions and 6 according to the plan. In the case of Oil Terminal and Electrica this information is not available.

The classification of the audit missions in assurance and counseling is done only by Romgaz, while Electrica is the only entity from the ones included in the sample that

presents detailed information on the number of auditors, at the beginning of the year there were five, then decreasing to three, out of which a person has a leadership role.

The number of recommendations is presented only by two of the five companies analyzed, namely Conpet reports 28 recommendations, while Electrica presents 38 recommendations, considering only those with a high impact at group level.

Regarding the external audit mission, the reports of the independent auditor were analyzed in order to observe the types of opinions issued.

It is important to note that 2 of the 5 entities in the sample are audited by BIG 4, more specifically by Ernst & Young and Deloitte.

Regarding the opinions issued, a single qualified opinion was issued, for SNN, and this is due to the fact that it was not possible to obtain sufficient and adequate evidence regarding the accuracy of the construction costs allocated on units 3 and 4 of Cernavoda Nuclear Power Plant, which has an effect on the assessment of these tangible assets under construction. At the same time, these limitations also have an effect on the

deferred tax liability, but the adjustments regarding the tangible assets, the deferred tax liability and the retained earnings could not be accurately determined by the auditor.

From the point of view of the number of key issues presented by the auditor, only in the case of Electrica were identified two key issues, in the rest of the analyzed companies being only one key audit matter, on which detailed audit procedures were applied.

The year 2018 represented the year of the change of the auditor for two of the five entities analyzed, Romgaz and Electrica. Romgaz changed the auditor from Deloitte to Ernst & Young, while Electrica changed from KPMG to Deloitte. In the case of Electrica, it should be noted that the uninterrupted duration of the previous audit mission, KPMG, is 16 years, starting with the financial year 2002.

In the report of the independent auditor, for Oil Terminal, the total uninterrupted duration of the audit mission is not mentioned, while for SNN and Conpet it is 3 years, and for Romgaz and Electrica one year.

## Conclusions

In many OECD economies, the state remains an important actor with property rights over the various entities operating on competitive markets. This property may be either in the form of equity investments in wholly or partly owned entities, or in the form of other organizational structures and instruments. Moreover, there are numerous cases in which the state, as a result of direct intervention or partial privatization, holds significant equity interests in listed entities (OECD, 2005).

There were analyzed 5 entities in which the state is a majority shareholder, or could in fact control the company, considering the number of shares held, referring especially to Electrica.

Regarding our main objective, we analyzed the elements of corporate governance from the point of view of the governing bodies, their size, the frequency of the meetings and not least of their independence.

The results highlighted that all entities in the sample analyzed adopted a unitary corporate governance model consisting of the Board of Directors, which is supported by other advisory committees. Also, from the point of view of the number of shares, the Romanian state has a high number, being followed by legal persons and then

by individuals. Dedeman SRL is the company that differs from the percentage held by legal entities, both in Electrica, but also in Conpet SA, being an active investor in the energy system.

From the point of view of the governing bodies, all the companies analyzed have a board of directors and executive management, but also a number of advisory committees which is also related to the size of the BoD, in 4 of the 5 entities, identifying three committees related to one BoD which includes seven members. Regarding the size of the BoD, there is homogeneity in the number of members, these being seven.

It is noted, however, that gender diversity is not yet a strong point in the entities in which the state is a majority shareholder, one of the companies having no female as BoD member, three other entities having only one woman, and Romgaz two. Also, in the case of Romgaz, Oil Terminal and Electrica it is the same person of female gender holding the position in BoD. Thus, the results show that gender diversity is still a point that should be improved in the future.

Regarding independence, the results show that the chairman of BoD is not an executive director in the same time in all cases, moreover in 3 out of the 5 companies analyzed, all the members of the Board of Directors are non-executive.

The frequency or number of meetings represents information that has been limited by their availability in public reports, which may be collected for BoD, but only in certain cases. The number of meetings is high enough.

Regarding the professional training of the members of the governing bodies, the results show an orientation towards the economic and engineering fields, followed immediately by the legal sciences. The age of the members of the Board is also limited information, in the sense that only for the BoD was collected from the public CVs of the members.

Regarding the executive management, in SNN there is the youngest general manager, while the changes of mandates that take place in Conpet SA and SNN, but also their interim period, may reflect a volatility that in the long term can lead to the instability of the entity on the capital market. This is also a point that could be improved in the future, so that investor confidence is not affected. In regards to the advisory committees, the results show a uniformity, as expected, in accordance

with the legislation in force. All companies have an audit committee, but also a remuneration and nomination committee.

From the point of view of the analysis of the "apply or explain" statement, there is a high transparency of the entities, as well as the assumption of the partially covered principles and the existence of a future implementation plan.

The secondary objective reflects aspects regarding internal control, ethics, internal audit, but also external audit. The results show that all companies have a well-established internal control system, as well as a code of ethics that they update in line with legislative changes. However, some entities are more transparent than others, such as SNN, Conpet and Oil Terminal, which present the number of identified risks, in addition SNN also presents the action plan to reduce them, evaluating them in terms of probability and impact. On the other hand, Romgaz and Electrica are not as transparent, only specifying that there exists an internal control system.

The above situation is similar with the aspects regarding the internal audit, in the sense that all the analyzed companies specify the existence of an internal audit department, but Oil Terminal does not present any other information, while the others disclose the number of missions, in some cases and their division into missions according to the audit plan or ad-hoc, but also the number of recommendations. Again, regarding the internal audit missions, transparency is not high and further improvements may be brought.

The results show that the Romanian state, being a majority shareholder, does not prefer an independent auditor who is part of BIG 4, only 2 of the 5 entities being audited by them. Moreover, in the case of Oil Terminal, the results show that prior to 2018, the entity was audited by the same BIG 4 for 16 years.

## Recommendations

The results of the study highlight some points that the entities in which the Romanian state is a majority shareholder might consider in the future.

Regarding the number of members of the executive management, it is recommended to respect the odd number mentioned in the Companies Law (Companies Law no. 31/1990), at present, noting that in three of the five analyzed companies, the number of members is an

even one, exactly two members in the case of Romgaz, respectively six in the case of SNN and Oil Terminal SA.

Regarding the frequency of the meetings, as well as their number, it is recommended to be presented for all the governing bodies of the entity, being observed for the sample analyzed, that this information was presented in particular for the BoD and the audit committee, not for the the other management structures.

Also, it is recommended the easy access of the investors and other stakeholders, to the information related to the professional training of the members of the BoD, respectively of the advisory committees and the executive management. At this moment, it has been observed that for some members, especially from the BoD, these informations are presented in the annual reports, but for the others, they can be found in the CVs of the respective persons. However, this makes it difficult to access information quickly.

At the same time, the results show that, in some cases, the period of the mandates and their duration are either not specified at all or are presented in a way that could generate confusion. We recommend a better presentation of this information, if this is already presented, and if the information does not exist, we recommend including it in the annual reports.

Regarding the internal control, we recommend that, even in the entities in which the Romanian state is a majority shareholder, to adhere to an uniformization of the type of information presented regarding companies in a sector of activity, in our case the energy system. The results show that there are companies that are not transparent about internal control, only mentioning that it exists, other companies provide detailed information, and others are found in the situation where they mention the number of risks without including measures to reduce them.

Regarding the internal audit, we recommend an uniformization of the type of information presented, the results showing that some entities mention only the number of missions, others do not mention them at all, and other companies include much more detailed information such as classification of missions in assurance and counseling, or missions according to the internal audit plan or ad-hoc. The information presented in the way it is today can reduce the comparability of companies.

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