

Corporate
governance failures
and scandals in
recent history
accounting essay



**ASSIGN
BUSTER**

\n[[toc title="Table of Contents"](#)]\n

\n \t

1. [Corporate Scandals](#) \n \t
2. [Committees](#) \n \t
3. [Corporate Governance Code 2010](#) \n \t
4. [Evaluation of the Corporate Governance Code](#) \n \t
5. [Conclusion](#) \n

\n[/toc]\n \n

In this essay, we are going to contemplate law, which is one of the most fundamental jurisdictional areas at present. Value will be given to the unraveling of the significant area of company law. One should acknowledge that in the past two centuries, several corporate collapses have overturn the facts in the business world and brought many changes in the corporate field in UK and abroad. In approaching this issue, the government seeks to prevent the repetition of accounting scandals and fraud. It introduces governmental regimes, that will set the framework in the UK corporate system. We are going to examine and analyze the basic legal issues arising with the application of the Combined Code and the UK legislation and whether their usefulness to the objectives of a company, is a fact or whether is a virtual reality.

In assessing this question, it is important to state that a good corporate governance is an indispensable demand for a large organization. A corporate governance, is considered to be the framework of rules, relationships, systems and processes within and by which authority is exercised and

controlled in corporations, while it encompasses the mechanisms by which companies and those in control, are held to account[1]. The main purpose of corporate governance is the facilitation of effective, entrepreneurial and prudent management that will be able to deliver the long-term success of the company[2]. The objectives of a company, are achieved through the completion of the procedures of corporate governance principles, that are set out in the Combined Code.

Corporate Scandals

Corporate governance failures and scandals in recent history, must be taken into account, in order to comprehend the reasons that have led to the creation of the Combined Code. The scandals came into the light involving well-known firms such as Maxwell, that was brought to the attention of the general public for problems associated with the management of pension funds and their security[3]. Another major scandal was the Enron scandal, who concerned several parties who gained personal benefits from illegal accounting procedures. In addition, WorldCom corporate scandal was the one where accounting irregularities led the firm to bankruptcy. In Polly peck the owner was accused of fraud because he owed a vast amount of money to investors. BCCI was found guilty of accusations of deception and the laundering of money. An important example which showed the need for an effective system was Parmalat which was similar to Enron's. The former events have highlighted serious shortcoming in worldwide pension legislation, and were behind policy-making throughout the decade[4].

Committees

These unforeseen corporate scandals gave impetus to governments and regulatory bodies to draft a Code that will guard the future of companies from situations such as these. Several committees were formed, concerning the development of corporate governance which is considered the internal means by which corporations are operated and controlled[5]. Initially, the Cadbury[6]Committee drafted ' The Report of the Committee on the Financial Aspects of Corporate Governance' which encouraged the firms to alter the structure and responsibilities of the board of directors, to increase the value and effectiveness of the audit and the relationship between the board and shareholders and concerned the responsibilities of institutional shareholders[7]. The Cadbury committee was followed by the Greenbury[8]committee, where it was acknowledged that the examination of directors' remuneration was a necessary demand. The Hampel[9]committee that took place in 1998, reviewed and updated the earlier recommendations by the two previous committees. This Final report emphasized on principles of good governance rather than explicit rule in order to reduce the regulatory burden on companies and avoid ' box-ticking' so as to be flexible enough to be applicable to all companies[10]. Furthermore, the Higgs[11]and Smith[12]Reviews formulated the Combined Code 2002. According to the Higgs Review the effectiveness and independence of non-executive directors are of importance, while with the Smith Review the role of the audit committee is established.

Corporate Governance Code 2010

The recommendations and principles of the committees on good corporate governance, have developed the Combined code. The Combined Code was first issued in 1998 and had received many updates since then. The Code that is in effect now is the Corporate Governance Code 2010. The Revised Code sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders[13]. It sets out principles designed to encourage shareholders, non-executive directors and auditors to accept their legal responsibilities and scrutinize the stewardship of companies[14]. The Code is considered to be a voluntary code, which applies to an extent in any company that chooses to adhere to it[15].

The committees made several recommendations. At first, they recommended that every company should be headed by an effective board, which will be collectively responsible for the success of the company and will provide entrepreneurial leadership, in setting the company's strategic aims[16]. In the Code it is mentioned that the board must have a sufficient size where the balance of skills and experience is the appropriate for the requirements of the business[17]. Accordingly, it suggested that the responsibilities at the head of the company should be divided between the running of the board and the executive responsibility for the running of the company's business[18]. In addition the roles of chairman and chief executive should be divided[19]. An illustration that supports this, is the scandals that were created by the Polly Peck, were Asil Nadir the owner abused the power that was in his hands. This is considered to be a

distinguished provision and if it is followed then balance of power will take place and similar situation will not be repeated.

In the Corporate Governance Code the issue of remuneration is being highlighted. The code provides that the role of the remuneration committee is an integral component for the corporate governance process and companies must go through a formal process in considering the developing policy on executive remuneration[20]. It provides that the board should establish a remuneration committee of independent non-executive directors, which should make available its terms of reference, explaining its role and the authority delegated to it by the board"[21]. The remuneration committee should consult the chairman or the chief executive about their proposals relating to the remuneration of other executive directors[22]. In Tyco scandal the chairman along with the chief executive were involved in fraudulent practices that were estimated at the loss of million dollars and were used for personal benefit. Apo4ii

The Cadbury Report referred to the important duties and responsibilities of an independent audit committee over the processes of corporate governance. The board should establish an audit committee of at least 3 non-executive directors, each of whom is " independent" and financially literate[23]. The audit committee assists the board in fulfilling its statutory and fiduciary oversight responsibilities relating to the company's financial accounting, reporting and controls[24]. The report of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit in 1999 pointed out that the audit committee should encourage procedures that promote accountability among the internal auditor, and the outside auditors , <https://assignbuster.com/corporate-governance-failures-and-scandals-in-recent-history-accounting-essay/>

ensuring that management properly develops and adheres to a sound system of internal control. An audit committee is designed to provide a level of assurance within the scope of corporate governance. In light of Enron and similar situations, scrutiny of audit committee performance is likely to increase, therefore it is more important than ever to ensure that audit committees are satisfying at least the basic standards of conduct[25].

Evaluation of the Corporate Governance Code

In the Corporate Governance Code importance needs to be given to the non-executive directors (NEDs). They were introduced by the Combined Code in order to prevent any future corporate governance problems. Each board should have non-executive directors[26]. NEDs have a crucial role in the operation of the board as members of a unitary board. In spite their knowledge and skills, they should constructively challenge and help develop proposals on strategy, they should examine the performance of management in meeting agreed goals and objectives and finally satisfy themselves on the integrity of financial information[27].

A fundamental quality that a NED needs to possess is independence[28]. This had become essential after the Enron and WorldCom scandals, because of the sensitiveness around remuneration, accuracy of financial disclosure and consequence of flawed strategic decisions[29]. Being independent means being capable of exercising objective judgment to task where there is a potential conflict of interest[30]. The crucial issue is whether NEDs are independent. They are appointed by executives and shareholders and it is accepted that most of them are considered to be from the same background as the executives and therefore to have a more friendly relationship between <https://assignbuster.com/corporate-governance-failures-and-scandals-in-recent-history-accounting-essay/>

them. This might affect their performance because if a problem occurs they might overlook it because of the more friendly association.

NEDs need to be objective and not to be affected by additional factors. At the beginning, it seemed to be distinctly effective, since they would ensure the director's actions and the company in general, in order not to give impetus to imminent scandals. However, we can state that they are not considered as a great solution since the work is not so effective.

Furthermore, the shareholder's effective communication needs to be evaluated. According to the principle there should be a dialogue with shareholders based on the mutual understanding of objectives[31]. It is considered very essential that the board is given the opportunity to communicate with shareholders. This will achieve a better governance because the aims and scopes of shareholders will be heard and hence comprehended by the board. Shareholders and the board, can have the potential to be each other's greatest source of development. Thus, by reinforcing each other's opinion will result to great solutions of numerous concerns and this will accomplish better governance strategies.

Additionally, a "comply or explain" basis is used when applying the Code on Corporate Governance. This approach was forwarded by the Cadbury Committee. According to this approach companies were obliged to either indicate whether they achieved to comply with the code in their annual reports or otherwise explain any areas of non-compliance[32]. This approach is not considered to be legally binding instead it is voluntary. Companies have the right to choice, yet when they choose not to implement the Code, a

rational reason must be given to the shareholders since they are going to be judged by it. The area of non-compliance is not very clear instead it is critical, but there is not an obligation to comply because the Code is not legally enforced. However the Code provides flexibility for those who choose to apply it[33]. Therefore this needs to be examined for a more effective work of the Code, nonetheless the 'comply or explain' mechanism can achieve a good governance structure .

The Code has raised the standards in the field of corporate governance. Through its implementation, it has become effective for several companies. From the first time it was introduced since now it has received many updates, in order to reach perfection. Nevertheless, the various principles provided by the Code need to be critically observed and improved. It is very important to signify that corporate scandals have been reduced, yet they are not vanished. Regulators need to focus on existing problems and provide major developments of unclear areas of the Code.

Conclusion

As has been shown, several issues arising from the application of the Combined Code and the legislative framework have been analyzed and embodied in the essay. Their extensive investigation, helped us root out whether the government actions in achieving satisfactory corporate governance procedures, can be established. Consequently, the Combined Code has improved the corporate governance standards, yet there are several inadequate areas that need to be developed. Concurrently, it is essential to justify that in order to promote a good governance, all aspects of the Code need to be effectively welcomed and applied, with both knowledge <https://assignbuster.com/corporate-governance-failures-and-scandals-in-recent-history-accounting-essay/>

and awareness of their usefulness, by the corporate system. A combination of the right people at the right place along with the current governance regime, can constitute the vital ingredients that over time, will ensure a successful company.