

What is good corporate governance accounting essay

[Business](#), [Accounting](#)



2. 1 Introduction

The practice of good corporate governance helps to differentiate one organisation from others. Corporate governance has been heavily researched in the past few years and at its most central point it refers to the governance of corporations. The latter has gained momentum as a result of separation of ownership and control as owners/shareholders have to be confident that directors and managers are perfectly managing the company's resources and are making sufficient disclosures. Numerous corporate failures like Enron and WorldCom have added more impetus to this phenomenon. In other words, the conflicts of interests in companies, management irresponsibility and voracity, corporate fraudulence, ethical breakdowns, very poor internal controls and weak risk assessment are some of the potential reasons that have triggered corporate failures. In today's businesses, corporate governance is viewed as a necessary exercise which has to be acknowledged and put in to practice for proper management of companies and competitive advantage. However, despite having the Code of Corporate Governance (2004) for Mauritius, State Owned Enterprises in Mauritius have strongly been criticised for poor practice of corporate governance. It has been reported by the DCDM Compliance Survey (2009) that only 44% of the state owned enterprises practice good corporate governance and it is an alarming subject as corporate governance is becoming an essential practice in any organisation. It has also been observed that the ownership of the state and the government control in fact represents an intrinsic governance challenges that in some way contribute towards poor performances of SOEs (OECD, 2004).

2.2 What is Corporate Governance?

Since past few decades, corporate governance has been a subject of much concern because of the increase of high profile corporate scandals and failures. The topic itself is a vague, intense and assorted one; yet studies conducted by various academics have been able to explore this subject matter to a high degree. Corporate governance can be defined as the process and structure that is used to direct and manage properly the business and the related affairs of an organisation with the prime intention of ensuring its protection, reliability and enhancing its shareholder value. This mechanism characterizes the partition of power and achievement of accountability, transparency, fairness and honesty between board of directors, management and shareholders and in the same measure of safeguarding the interests of depositors and other stakeholders. Jones and Pollitt (2002a) illustrated that corporate governance is the way the company's board of directors is organised and functions. Sir Adrian Cadbury advocates that " Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals... the aim is to align as nearly as possible the interests of individuals, corporations and society" (Corporate Governance Overview, 1999, World Bank Report). Therefore, it shows that organisations should not only be viewed as a medium for the achievement of the shareholders' wealth maximisation; but rather it should be seen as an essential part to have a duty of care to society and other stakeholders. The OECD (1999) values the importance of having proper regulations and legal framework that can assure shareholders' rights and that can ascertain fair treatment of

shareholders regardless whether they are in the minority or majority. Khoza and Adam (2005) furthers this concept by underlining corporate governance is about having an effective financial accounting and management, proper risk management processes, effective monitoring and controls, independent auditing, accountability and significant sustainability reporting and transparency. On a closer analysis, we will note that all these definitions of corporate governance tend to focus on shareholder and stakeholder value. Corporate governance is about assuring a return on investment to its shareholders (Vishny and Shleifer, 1997) and at the same time adhering to laws and legislations, rules and regulations and other important factors that control the running of a company.

2.3 Good Corporate Governance

Numerous definitions of "Corporate Governance" have been brought forward by various authors which indeed help in the flow and management of processes and structures of businesses and how they must be directed, managed and controlled. However, when several researchers have analysed the depth of this matter, they opined that the main and essential focal point should be on good corporate governance. Various studies have shown that companies that have embraced the practice of good corporate governance will benefit from improved competitive advantage, attract potential clients and investors, better financial performance and long-term sustainability. Murthy (2006) put forward that good corporate governance is a corporate system that helps in directing in the maximisation of shareholder value in both ethical, legal and in a sustainable manner, by ensuring fairness and

transparency to both shareholders and stakeholders. Claessens (2003) conceptualized that the practice of good corporate governance ensures better management and performances of organisations, financial institutions and the market as well. According to Frederick and Keith (2006) " Good corporate governance helps to prevent corporate scandals, fraud, and potential civil and criminal liability of the organization. It is also good business. A good corporate governance image enhances the reputation of the organization and makes it more attractive to customers, investors, suppliers, and in the case of non-profit organizations, contributors." It has also been claimed that good corporate governance ascertains the sustainability of companies (Mardjono, 2005). Furthermore, it ensures the total conformance of organisations by taking in to consideration the interests of both investors and the society as well by creating transparency, fairness and accountability in all business activities (Oman, 2001). It has been pointed out by various researchers that good corporate governance is about having well-defined shareholder rights, a strict environment of control, high degree of transparency and disclosure, a strong board of directors which can contribute towards ensuring the proper functioning of the business, a good reputation and attracting potential investors as well. It has been brought forward by Black et al (2006) that a study revealed that organisations which are well-governed in Korea traded at a premium of 160% compared to very poorly governed organisations. Another study conducted by Deutsche bank demonstrated how organisations with firm or improving practice of corporate governance supersede those firms which have very weak practices of good governance (Grandmont et al., 2004). According to Eichenseher and Shields

(1985) and Pincus et al (1989), the practice of good corporate governance helps to monitor and reduce potential conflicts of interests in an organisation. In a 2002 McKinsey survey, institutional investors strongly claimed they would accept to pay premiums to hold well-governed organisations on an average of 30% in Eastern Europe and Africa and a percentage of 22 in Latin America and Asia respectively (IFC, 2006). Companies based in U. S. which have the practice of good corporate governance have quicker sales growth and reportedly they were more profitable than other companies in the same field (Gompers et al., 2003). Addressing the subject, it can be said that there should be commitment to sustainable corporate development and continuing high ethical standards and corporate and social values in both business and society, effective boards and management teams which work for long term benefit of both shareholders and stakeholders, transparency and fairness in corporate governance settings.

2. 3. 1 Characteristics of Good Corporate Governance

According to UNESCAP, good governance has 8 characteristics namely; Accountable, Transparent, Responsive, Equitable and Inclusive, Effective and Efficient, Follows the rule of law, Participatory and Consensus Oriented which will be described below.

2. 3. 1. 1 Accountability

Accountability can be said to be considered of fundamental importance when good corporate governance is being considered. Branscomb (1995) illustrated accountability as an acceptance of responsibility. Accountability

also brings forward the role of the board of directors; that is; to be constant with the interest of their shareholders. According to the Cadbury Committee Report (1992), it is the board of directors which need to ascertain and provide its shareholders with adequate and correct information to their shareholders about the economic situation of the company.

2. 3. 1. 2 Transparency

In business terms, transparency means that decisions and processes are being taken and followed in such a way that it adheres to rules and regulations of the firm and all required information are made available to the public in general. The main shareholders and stakeholders of the SOEs can be said to the public in general. The OECD (1999) stresses out the full transparency is a fundamental component for corporate governance. Bicksler (2003) advocated that transparency can be in terms of having the financial accounting statements clear as crystal. Some even opined that transparency is about letting both shareholders and stakeholders know the economic situation of the company. According to a study conducted by Mitton (2002) companies which adhere to strict transparency standards somehow did better than those companies with weak transparency and disclosure principles.

2. 3. 1. 3 Responsive

Responsiveness can be defined as the ability to complete a given task within time limit. Good governance requires organisations to perform their given tasks by respecting the given time frame so as to meet the needs and requirements of all stakeholders.

2. 3. 1. 4 Equitable and Inclusive

Equity and inclusiveness are important aspect when an organisation is considering the application of good governance; as through equity and inclusiveness, the organisation will be able to ascertain that all the members of the society irrespective of their level are well served and feel part of the organisation.

2. 3. 1. 5 Effective and Efficient

Effectiveness and efficiency in good governance means that procedures and organisations deliver outcomes that meet the needs and requirements of the society. It is about making proper use of the society's resources and protecting the environment as well.

2. 3. 1. 6 Follows the Rule of Law

This characteristic of good governance means that all organisations should abide by all required laws. All fundamental rights should be respected and protected. This feature of good governance also requires an independent judiciary system and unbiased and honest police force.

2. 3. 1. 7 Participatory

Participation is way to provide freedom of association and expression of each and everyone in the society. Both genders are required to participate in an organisation as it is a way to practice good governance. Participation needs to be informed and well ordered.

2. 3. 1. 8 Consensus Oriented

The consensus oriented approach is a way to align different concerns in the society in order to come on a broad and final agreement in society and identify means and ways to identify and achieve the best interests of the society. The consensus approach also help the organisation to make long term vision for sustainable human growth.

2. 4 Corporate Governance in Mauritius

Corporate governance in Mauritius came as a response to numerous businesses failures that the Mauritian economy had experienced. Financial scandals where five commercial banks listed on the Stock Exchange of Mauritius Ltd namely the Bank of Credit and Commerce, the Habib Bank (Zurich), the Mauritius Cooperative Central Bank, the Union Bank and the Delphis Bank have been forced to close down whereas the Banque Nationale de Paris Intercontinentale, Citybank (Boulle and Prosper, 2003) indeed played a significant factor for Mauritius to come up with more severe laws and regulations. In the same dimension, it has been reported a fraud of nearly 1 billion at the MCB/NPF. All these financial scandals do trigger a wake up alarm for good corporate governance. Henceforth, a series of laws and regulations have been introduced and put in to practice and some even amended. They are as follows: The Companies Act 2001The Financial Intelligence and Anti-Money Laundering Act 2002The Financial Services Development Act 2001The Financial Reporting Act 2004The Banking Act 2004The Introduction of the International Accounting StandardsThe setting up of a National Committee on Corporate GovernanceA committee was

established in 2001 by the Ministry of Finance in order to develop and bring forward a code of good governance for businesses performing in Mauritius. This committee was assigned to draft the code and spectacular scandals like the Enron, WorldCom and Tyco and the Higgs Report (2003) and Smith Report (2003) were being taken in to consideration. The five principles of corporate governance by the OECD were also taken note of which are as follows: The Rights of Shareholders The Equitable treatment of Shareholders The Role of Stakeholders in Corporate Governance Disclosure and Transparency Responsibilities of the Board This code requires all companies to comply as from the reporting financial year ending 30th June 2005; that is; as from July 2004. This applies to all companies listed on the Stock Exchange of Mauritius, large public companies, banks and non-banking financial institutions, statutory corporations, parastatal bodies and large private companies. The code highlights three main subject matters: the governance structure, the internal governance mechanisms and the reporting and disclosure. Governance Structure The code sees a board compiled of executive, non-executive and independent directors capable of leading and controlling an organisation and must be people of knowledge, skills, and experience. Committees can be set up by the board to carry out tasks and hence report to the board. Internal Governance Mechanisms Organisations are expected to have a structure of risk management, internal control and internal audit function. The board must make sure that the company makes proper execution of those systems; to achieve its objectives. Reporting and Disclosure Directors must act in total compliance with the IFRS; their accounts must honestly show the current

state of affair of the organisation and the results of its operations. There is also mention of external auditing for ensuring veracity in financial reporting. In today's businesses the practice of corporate governance has become a necessity for its success. Conversely, on a closer look we will observe that there more need for good corporate governance so as to ensure long term sustainability for companies.

2. 5 SOEs in Mauritius

Mazzolini (1979) defines SOEs as an entity for which the final formal power rests in the hands of the state. Aharoni (1986) defines SOE as an organisation whose capital is wholly or partially provided by the local government. SOEs in Mauritius are being controlled either directly or indirectly by the government. The State is the " owner" and takes part in the decision making process. SOEs operate under the guidance of a Ministry and have their own goals and objectives. The companies which are directed by the government operate either under a particular act of the legislative body or they are registered under the Companies Act 2001. Aharoni (1986) elaborates further on SOEs stating that is firstly a public sector; that is; owned by the government, secondly it is an enterprise deals with the production and sales of goods and services and thirdly the sales proceeds of the SOEs should allow some relation to cost. According to Ramanadham (1984), for the SOEs, it is the government who makes the entire decision making, the public is considered as the main shareholders and stakeholders. However, serious matters have been brought forward by the OECD guidelines on Corporate Governance (2004) on SOEs. It has mentioned key

challenges faced by SOEs in attaining good corporate governance; firstly to better recognize the ownership task within the state management and secondly to empower and strengthen boards. It has been noted that members of Board tend to change frequently or since there are representatives of ministries on the board; there is a tendency that not the same member attend the board each time. In addition, since members are appointed by the Government; the board's ability to function independently may be hindered. Members representing the Ministry are in a better place as they serve as an important link between the Ministry and the board. However, this position is often misunderstood and taken advantage of. Representatives of other Ministries may also not be totally independent as their respective Ministry may be in conflict. Lastly, there has also been mention of improving transparency of their objectives and performance.

2. 6 Governance in State Owned Enterprises and their Impacts

2. 6. 1 Objectives of SOEs

The government being the " owner" has a lot of social objectives; welfare of the country, economic prosperity and peace amongst others to accomplish. Aharoni (1986) brought forward three different objectives of SOEs which are firstly that SOEs need to work in the interest of the whole nation so as to enhance the society; that is providing employment and continuously investing in the society. Secondly, SOEs should work in the view of maximising efficiency through performance so as to increase their profitability and satisfying their shareholders and thirdly SOEs should serve

both its customers and workers by having their representatives in the board of directors so as to best serve their interest. On the contrary, it has been observed by various researchers that most of the SOEs do not have clear objectives. The government most of the times tend to follow rules and regulations set by other; that is; rules set by international standards. Cameron (1992) conceptualises that all of these give rise to conflicting objectives and therefore difficult control on performances. However, Aharoni (1986) elaborated on the fact that indeed it is very difficult to set clear objectives for SOEs as these objectives are not always equitable from different parties' eyes. Objectives in SOEs are very difficult to be measured as it is very complicated to find an equitable way to differentiate between them. More so, Aharoni (1986) very sharply pointed out that objectives not properly defined and are vague; which encourages the practice of hidden agendas of the government, ministers and political officials so as they can twist and turn objectives according to their own comfort.

2. 6. 2 Board of Directors in SOEs

According to Rechner (1989), the board of directors is considered as a very important aspect to good corporate governance as it links the company to both its shareholders and stakeholders as well. Carver and Olivier (2002) illustrated that the board of directors are assigned with the duty of improving company's performance, attract investors, protect the company and also brings skills, knowledge and experience to the company. The government and the ministers appoint the Board of Directors of the SOEs which in turns manages the SOEs. The Board appoints the CEO who is in charge for the

daily management of the organisation (PRB Report, 2008). Aharoni (1986) pointed out that in SOEs there is no need to have a board as it is the government which is primarily in charge of them and if SOEs legally need to have a board it should be chaired by the minister concerned. However, on a closer analysis, it can be said that the board of SOEs should function independently; without political interferences. Members of the board should be those with adequate knowledge and experience in order to better serve the SOEs. Mar and Young (2001) are of opinion that the board of directors are usually appointed for political reasons instead of having experienced and qualified people on board. Rechner(1989) noted that it is the CEO who holds the overall control on the board and even if outside independent directors are being appointed they only act as "rubber stamp". Moreover, Fernandes (1986) pointed out that the government must be very cautious while nominating members of the board as these members should be capable to taking the right decisions for the companies instead of continuously waiting for the approval of the government for any decisions. By having political exposed people on the board, somehow facilitates government decision making and power on the board. It has also been observed that a change in government always leads to a radical change in board members of SOEs.

2. 6. 3 Board Committees in SOEs

Board committees can be defined as a committee comprising of members of board of directors in order to carry out tasks given by the board. Committees are being set up in order to help the board to have a better control over the organisation; hence making it easier to achieve its objectives. According to

the Code of Corporate Governance for Mauritius (2004), all companies should have at least an audit and a corporate governance committee. Each committee should have its objective, composition, reporting lines and procedures to follow. The audit and corporate governance committees are now being considered as necessary components which aid the company to act correctly and in its best interests. The audit committee acts as a link between the auditors and the board. The audit committee should focus on the internal control mechanisms and the internal audit department. It should assess the correctness of financial information and ascertains that the company is adhering to all legal framework of the country. Neither the chairperson nor the CEO should not be members of the committee; instead an independent director should be given the task (Code of Corporate Governance, 2004). The corporate governance committee is being put in place in order to ensure the reporting needs on corporate governance are in line with the Code. An independent non-executive director should be the chairperson of the board and the CEO " may be a member" of the committee (Code of Corporate Governance, 2004). The code also puts forward that it recommended that for both audit and corporate governance committee should be comprised of a majority of independent non-executive directors. Having board committees in SOEs, somehow help the board to have a better control over the internal processes of the organisation and also helping SOEs to keep pace and be in the same line of competition as the private firms as private firms are renowned to have better and more effective audit and corporate governance controls.

2. 6. 4 SOEs and Agency Theory

Eisenhardt (1985) defines agency theory as the organisation of relationships where the primary party establishes the work which another party takes on. This theory debates on the circumstances where incomplete information and uncertainty prevails and where agency problem crops up; that is; where the primary party cannot determine whether the other party has correctly has done his/her work appropriately or not. Simanjuntak (2001) illustrates how agency problems affect the practice of corporate governance when issues arise from the separation of management and ownership. According to Coase (1937) the agency theory is based on the idea that people cannot be totally trusted to act in the best interest of others as they are most concerned with their very own interest. So on a closer look; we will observe directors of companies under the agency theory will take decisions in their self best interest instead of the interest of shareholders and stakeholders. For SOEs, it can be said that the agency problems take place due to the composition of ownership of the institution. It is principally about the structure of the board, the devising of strategies and decision making, the processes of reporting and control means. The best interest of " owners" of the SOEs are being given primary concerned by the management and the management as a result line up their self interest with that of the owner of the firm. This relationship between the owner of the firm and the executives can give rise to nepotism, favouritism... etc.

2. 6. 4. 1 SOEs and Stakeholder Theory

According to Freeman (1997), the stakeholder theory surfaced in the 1970s as a result of the overpowering nature of multinationals on the society.

Before, organisations were only concerned with their shareholders' benefits; but today this concept has become much broader as firms should not only care for their shareholders; but its various stakeholders as well (Sato, 2004).

Tirole (2001) opined that this stakeholder theory approach somehow oblige firms to think and act towards the welfare of its various stakeholders. SOEs can be said to have a more composite set of stakeholders as they are necessitated to meet social goals and objectives together with maximizing profits.

2. 6. 5 Transparency and Disclosure in SOEs

The OECD (2005) claimed that transparency and disclosure are much more important to SOEs compared to other companies as SOEs are accountable to the parliament and public directly. For SOEs, transparency and disclosure depends mainly on quality, accurateness and relevance of the dossiers.

However, the OECD (2005) also brought forward difficulties of SOEs, as SOEs have more complex set of objectives to be accomplished as they work hand in hand with the government policies and this somehow hinders the level of transparency and disclosure. Moreover, the Report of the Director of Audit (2010) of Mauritius mentioned that parastatal bodies in Mauritius do not have to provide report on their financial affairs and efficient use of their given resources to the Public Accounts Committee which is an emanation of the government and which is responsible to examine audit reports of

ministries, statutory and local bodies and report to the government about their findings. This is an alarming issue as we can see that parastatal bodies are held outside the inspection of the Public Accounts Committee. All these points call for the need of a better practice of good corporate governance. In addition, studies by the OECD (2005) have also shown a lack of commitment and motivation from both the government and managers of the SOEs which affect the level of transparency and disclosure.

2. 6. 6 SOEs and Internal Audit System

Bringing and achieving independence and objectivity in the internal auditors' work has been subject of much debate in SOEs in precedent years.

Researchers like Gansberghe (2005) has put forward that there is still a challenge when it comes independence of internal audit in SOEs. This is so because of the constant government intervention to the function of internal audit. A bulk of surveys conducted by various researchers indeed showed that internal auditors do face conflict when it comes to bringing independence and objectivity in their work (Paape, 2007). Van Peurseem (2005) noted through her survey that indeed when it comes to independence in internal auditors' work, the latter do face conflict between " their audit oversight responsibilities and the provision of support to the management". Many believe that there is much discourse between the " seeable" and the " sayable" in internal auditors' work. In addition, Brody and Lowe (2000) together with Ahlawat and Lowe (2004) illustrated on the clash in achieving objectivity of internal auditors' work. Through their research they showed how when acting as consultants, internal auditors' are not able to sustain

their objectivity. Moreover, as internal auditors are employed by the organisation, this can disturb their reporting tasks of fraud or errors to the senior management as they will remark this as a threat to their present position within the company.

2. 7 SOEs and Corruption

Corruption can be defined as " the acts in which the power of public office is used for personal gain in a manner that contravenes the rules of the game" (Jain, 2001). Various academics have observed that those people who are involved in corruption are mostly public officers and politicians, who somehow have a control of the power. Politicians tend to always favour their re-election or promotion instead of working for the betterment of SOEs. They tend to make misuse of their political powers and work hand in hand with managers of SOEs and governmental authorities (Nguyen, 2006). It has also been observed that the close relationship that exists between SOEs and public officers are usually viewed as a source of corruption. Researchers have identified various forms of corruption that takes place in SOEs which are abuse of power, uninformed decisions of policies and administration, very poor accountability from responsible staff member and government authorities as well, and very poor monitoring from the government's part. It can be said that lack of precision on regulations creates encouragement for opportunistic activities of SOEs officers.

2. 8 SOEs In Other Countries

2. 8. 1 Thailand

According to Thailand Budget Procedure Act 1959, its SOEs are organisations in which its government own more than 50% of its equity share. Studies have shown that SOEs in Thailand also endure agency problems which hinder the functioning of its SOEs and economic progression as well.

Montreevat (2005) observed that Thailand has been making efforts to reform its practice of corporate governance in SOEs; however, little has been done to improve the level of transparency. Researchers have noted for SOEs in Thailand need to a clear partition in its guiding principles and regulations so as its SOEs can work outside from political pressures and interferences. However, political ambiguities still come into view in Thailand.

2. 8. 2 South Africa

In South Africa, both SOEs and private companies are being governed under the same legislation; it's Companies Act. Both of them should file annual return for the purpose of transparency, disclosure and accountability. Its Companies Act does not make any disparity between SOEs and private owned enterprises. South Africa's governance principles are based on the King II Report on Corporate Governance. However, many researchers have observed that South Africa practices of good corporate governances are very weak compared to countries which have same regulating standards for both private companies and SOEs. Academics are of opinion that the political system of the country and propagation of bribery somehow hinders the practice of good governance in SOEs.

2. 8. 3 India

SOEs in India are considered to be acting as major pillars in the contribution of the Indian economy. However, according to the World Bank (2006) Report, in India the final choice for selection of its board members and CEOs are done by the ministries of the elected government which signifies that SOEs in India are being subject to political issues, conflict of interest, agency problems and pressures as well. Some academics are also of opinion that such interferences somehow hinder the work of the top management and prevent them from performing their tasks correctly. It has also been observed that corruption is rampant in the functioning of India's economy and now it is becoming even worst. Academics have put forward, that the widespread presence of government in SOEs is one of the main reasons for the birth of corruption in the midst of India. It has also been brought forward that the legal system of India is uneven throughout the country and its legal procedures are lengthy, costly, and subject to political interferences.

2. 9 SOEs And Privatization

Many scholars opined that " Privatization" can bring a reform to SOEs' problems. Privatization can be defined as " the withdrawal of the state from the production of goods and services" (Veljanovski, 1987). It is a change in role, ownership, responsibilities and authority as well. The concept of privatization came as a response to the problems associated in the functioning of SOEs and it is considered that the government as the owner is not a good entrepreneur. SOEs having so much of loopholes in its poor management and difficulties in the assessment of its performances somehow

call for the need of privatization. Academics like Bienen and Waterbury (1989), privatization of SOEs will help these organisations to compete successfully in the market and also it will reduce the government role in the economy; thus encouraging more healthy competition. In the same dimension, Nellis (1994) identified five factors which support and favour the introduction of privatization of SOEs. Firstly, by privatising SOEs, managers will try to achieve a higher quality of management. Secondly, capital market place private organisations to a much larger degree of inspection and discipline compared to public institutions. Thirdly, Nellis (1994) found that private companies are more likely to be prone to bankruptcy, insolvency and closures which in a way motivate managers and owners to be more risk adverse. Fourthly, it has also been noted that politicians are less likely to interfere in the management of private firms compared to SOEs. Lastly, the latter has analysed that unlike SOEs, boards of private firms are better managed by self engrossed board members and shareholders who help them in performing efficiently and effectively.

2. 10 Conclusion

Concluded from the above research study it can be said that the true facet of the current practice of good governance together with its loopholes in SOEs have been untied to a very large extent and bringing forward the whole masquerade of the present SOEs' system. It has also painted several barriers, issues and challenges pertaining to SOEs and preventing them from achieving good corporate governance. This brings this study to another

extreme as whether SOEs will continue to work in this direction or there is still a light of hope at the end of the tunnel.