Elements, Characteristics and Principle for Effectiveness Governance in Public Sector

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Abstract

Objective: This article analyses elements, characteristic and principle of corporate governance in the public sector. We are going to explore the significance and identify the need for a good governance in public entities. Methods: This study emphasizes comparative analysis of advantages and disadvantages of corporate governance. It also used historical methods for demonstrating the importance of progress in the concept of corporate governance. Several past research journals have been used to present a blend of the need and characteristics of Corporate Governance in the public sector. Through this study, the researchers have made an effort to prove the importance and effectiveness of corporate governance in the public sector. Findings: Delivering public services and satisfying public need is the most important goal of public authorities’ corporate governance. It also has aim to increase shareholders profit through obtaining citizen satisfaction. In addition, satisfying the need of client (citizen) can improve public benefit. Application/Improvements: The main areas of research interest in this still incipient area and it illustrates the ways in which public sector approaches to codes of good practice, corporate ethics and social responsibility differ from their equivalents in the private sector. This study explains and analyses the fundamental concepts of the Corporate Governance of public entities. Also, authors have aim to explain effective governance in the public sector.

Keywords: Corporate Governance, Characteristics, Effectiveness, Elements, Principle, Public Sector

1. Introduction

One of the concepts that have field in specialized literature and also in practice is public entities’ corporate governance. This concept includes clear principles, for example, integrity, honesty, sincerity, transparency and also responsibility as a control method and leadership in the public sector: Public entities of any kind plays a fundamental role in the economy and governed from every country. They are decisive in the development of functions of the State and represent a means to grant citizens, resources and / or services that these require to have a better quality of life. However, as it is presented economic growth, the entities public face greater complexity in the management of capital public and a higher requirement in the administration and control thereof. For such reason, the way to govern said public entities becomes more complicated. While there is a lack of credibility towards public sector entities, it is also necessary to recognize that these cannot improve without participation and support of citizens as main change’s agents.

Corporate Governance (CG) is a mechanism that serves as a guide and counterweight to the administration of the entities for ensure transparency in their operations, the results of a good management and efficiency in the products and services that are offered. Supported in this mechanism, public entities can perform an activity independent, objective and strengthening to your administration to add value and improve your operations. The fact that public entities are different from private compa-
nies do not imply that the administration of they must be different. In fact, the governance of these requires that take a much stricter process that all the resources that are used and all the benefits that are obtained belong to the third parties involved, is tell all citizens\(^3\). The first part of this research involves definition, history, development and importance of Corporate Governance. The second part talks about corporate governance and its application in public sector. The authors in the second part have emphasized on the elements, principles and characteristics of Corporate Governance in Public Sector. And in the concluding part we have specifically discussed, analyzed the importance of Corporate Governance in Public Sector.

2. Research Questions

Below are the research questions that need to be answered;

- Whether corporate governance is necessary in public sector?
- Whether the principles of corporate governance effective in public entities?

3. Research Methodology

Through this research, we have analyzed the importance, advantages and disadvantages of Corporate Governance. The research begins with the definition, history and evolution of Corporate Governance through time. We have discussed about the effect of change it has brought into the private sector, and also have discussed about the need and characteristics of Corporate Governance in Public Sector. The authors have tried to show, how important and effective is corporate governance in public Sector.

4. Literature Review

4.1 Importance of Corporate Governance:

Corporate governance refers to the group of good practices that derive from proper management and accountability of private companies and public entities. Good Corporate Governance plays an important role as a navigation chart that helps the public administration, not just define and monitor the achievement of their objectives, but also allow for a line of command, with clear responsibilities on the part of the State as owner, of the Boards as long-term strategic instances, and of senior management as executors of that strategy. That is, the application of good practices. Corporate Governance helps to contribute to the best performance of the institution. In that way, it allows the State to act, without directly engaging with the daily operation, as a responsible and proactive shareholder, which seeks to maximize the value of the company, depending on the purpose for which it was created, be it economic or social. In the same way, the application of good Corporate Governance practices allows that neither the Board of Directors nor senior management are in a position to capture the company to the detriment of the State - in its role as owner and that rather act in line with the established objectives\(^4\).

In addition, these good practices allow the minority groups, if they exist, have an equitable treatment, so that access the same information as the majority shareholder. Additionally, it is important to highlight that Corporate Governance does not respond ideological lines and, on the contrary, the adoption of these guidelines is neutral as regards the willingness to hold the assets of these companies in hands of the State or not. In this sense, it should be emphasized that it is a tool essential for achieving the ultimate ends for which the SOEs have been created\(^5\).

4.2 The Need for a Good Governance in Public Entities

The increasing complexity of government entities has done necessary to establish more and better controls to the administration of public companies under the important deficiencies in the system of handling of them. In general terms, they can identify the following factors as those responsible for a bad process of Governance\(^6\):

- The lack of a market competitive and the consequent lack of need for effective processes and efficient.
- Easy access of the entities to the financial resources, which can generate an economic waste eloquent.
- State support for entities public, which affects the responsibility that in other circumstances should assume their administrators faced with the shortage of resources.
- The political periods and their changes that oblige entities to change your prospects for goals and policies.
Corruption that promotes management of resources according to interest’s personal, in addition to inefficiency of regulatory agents to avoid the same.

4.3 Principles for Governance Effective in Public Entities

In the public sector, where officials are employed by State institutions with the responsibility of implementing and executing government policies determined within the framework of the law, accountability becomes a utile more complex for political and economic interests, especially if there is no adequate institutional framework. At the international level, reforms have been introduced in the public sector with the objective of promoting responsible administration, with the conviction that the principles of good corporate governance are also relevant and applicable at the public sector level, where assets and resources are managed of a country. But the simple statement that an institution will be governed by principles of good corporate governance does not ensure that in real life this goal will be met, if there is no culture, systems, controls and mechanisms to punish abuse and corruption to ensure that an institution effectively adopts and is governed by these principles.

Within this context, there are some concepts that are vital to make a public institution work within the framework of good corporate governance. The following can be mentioned:

- Rule of Law: to have a strong institutional framework;
- Transparency: to ensure that stakeholders have confidence in the decisions and actions of public sector entities;
- Integrity: to ensure honesty, objectivity and probity in the administration of public resources and in the management of the affairs of the entity. Integrity depends on the efficient functioning of an adequate control system and on the professionalism and principles of the people in charge of the institution;
- Accountability: to ensure that both the institutions and the people who direct them are responsible for their decisions and actions.

The image shows the integration of the elements of government and the need to integrate them in a single point. The good management of these factors leads to public entities to get a good governance. Within a company, it is called shareholder to the one who owns the society. In the public sector, the entities represent a part of the property of each one of the Mexicans, so the shareholders of the companies. In good corporate governance the shareholders are fundamental in making of business decisions. For such reason, it is the responsibility of the citizens to be aware and to the pending of the management of public entities these are part of your estate and through of their proper governance, generate benefits for the community in its set.

5. The Appearance of the Corporate Governance Concept

The repeated financial abuse and frauds in developed countries like United States, UK and Italy gave birth to the concept of Corporate Governance.

During the early 70s, for the first time, Corporate Governance was witnessed at Watergate Scandal in America. Soon after in 1980s and 1990s, many listed companies like Polly Peck International (1989), Maxwell (1991) and The International Trade and Credit Bank (1991) in United Kingdom went bankrupt.

Public sector likes the private sector may be faced with financial abuse and fraud. For example, one illustrative example happened in 1995, where Antony Williams was charged as a deputy manager of finance of the metropolitan police. He stole more than £5 million in 8 years (1986-1994). Another describing example is Inland Revenue case of 1997. In this case, Michael Allock worked in office NO.2 and was responsible for investigating the foreign business. He was found guilty for foreign business people’s taxes from 1987 to 1992. Allocks’ accusation was using the service of a prostitute in exchange for specific information, bribery and family vacation payment by certain business people. As a response to all frauds and financial failures, different competent bodies determine need, original and initial of changes by tighten the CG laws in companies and adopt transparent policies and ethics.

Today, almost every developed or developing country have their own Corporate Governance Code, issued by their respective ruling bodies. European Corporate Governance Institute’s website http://www.ecgi.org/ quotes an estimate of 409 corporate governance code is developed globally. Sabanes-Oxley issued at USA is
ranked to be the best among all the developed codes, followed by Cadbury Code and United Kingdom Code. These codes were formed as a result of the various scandals and Corporate failures. It can be concluded that the aim of corporate governance regarding the context of 70s to 90s Scandals, was to balance the power between management, stockholders and administrators.

The optimal division of power among the three could prevent financial abuse and restrict financial frauds. Thus, gain back the trust of the society in the business environment.

6. Defining the CG Concept

The first author who showed his interest in testing and researching in CG and also the reasons for the financial failures was Adrian Cadbury. In 1992, he was the president of the Committee for Corporate Governance Financial Aspect. As a result, he published the Cadbury Code. In his report, he defined CG as “the system by which companies are managed and controlled”\(^1\). The world bank and the Organization for Environment Cooperation and Development (OECD) are two international bodies that focused on CG and reasons of financial failures. Based on the statement of the OECD report on Corporate Governance in Romania, CG demonstrates\(^1\):

1. A set of the relation between the administration board, management at the company and its shareholders.
2. The structure by which organization targets, means for performance and achievement monitoring dials are set.
3. The motivation system given the Administration Board for the monitoring of targets, which are in the stockholders and company’s interest and for assisting, help companies to use reasons more efficiently.

In addition, according to the Australian National Audit Office (ANAO), 2003, “Corporate Governance refers to the processes by which organizations are managed, controlled and owned. This refers to authority, responsibility, administration, management, guidance and control within the organization”\(^1\).

The United Kingdom Corporate Governance Code (2012) suggests that corporate governance refers to “what a company’s Administration Board does and the way it sets the company values, and it is different from day-to-day operational management by full-time managers”\(^1\).

Finally, that: “Corporate Governance refers to the way a company’s funding providers ensure that they will receive the due benefits of their investment”\(^1\).

7. Elements of CG

Elements of corporate governance are\(^1\):

7.1 Relations between Shareholders’ Directors and Process Managers

On the basis of agent theory, under American Model Function, the rightful owner or representatives of the company, elect the directors of the Corporate Governance Committee. These directors have the function to supervise and govern the company. To achieve goals, the directors analyze society’s demand, develop a strategy and the market expectations. The corporate governance model should work efficiently, when the staff and directors are completely capable, honest and professional.

7.2 Dimensions of Conformity’s, Accountability and Performance

The dimensions of strategic performance and those of accountability of published accounts should be added for the functioning of the corporate governance model. It is directors’ responsibility to set goals and objectives and according on these, develop regulations, and policies and strategies in the specific fields of activity. Directors must establish key performance indicators for all set goals and also present targets. The directors’ accountability regarding the firm’s result under their delegations will be materialized in the reports they will provide, on the structure of the firm’s final accounts and the analysis of the achievement of the performance indicators.

7.3 Corporate Law and Regulations

The legislative framework adjusts the corporate field must help to the protection of groups that have investment in the organization and also other people who have interest in organizations product or services. Moreover, the regulation framework is responsible to add value to the organization and to make sure a competitiveness level in the organization.
7.4 The Final Account and Ethical Standards
According to international accounting standards, annual reports must include all information that users need and it must present in a real manner. In addition, final accounts should create a connection way between the organization and outsiders. As a result, interested users may receive a clear perspective about organizational performance and the way in which management is behaving.

Ethical standards present a permanent concern and set by the organization. Ethical standards are responsible to make sure that objectives are set.

Ethical standards should be given priority in all important organizational decisions and also should be a platform for all activities in organization. At the same time, these standards should pay attention to the human resources system, for example, professional training, conflict management and evaluation.

Ethical standards are a part of a consistent message of the managers’ value. All employees and staffs need to be persuade to report all potential or current risks on the organizations, customers or even shareholders and management should have positive response and action.

7.5 External Audit
External auditors are meant to verify organizational assets and its debts at the end of financial year. They also check whether the organizational accounts properly reflect its financial performance. External auditors are going to finalized with an audit report on annual accounts.

7.6 The Audit Committee
One of the key element of the board of Directors is Audit Committee. It is composed of at least three non-executive directors. Their key responsibility is to supervise the corporate governance process, and preparation of annual reports for shareholders. In addition, this committee must check internal control system and to be sure about competent of general management to implement an effective risk management within the organization.

Audit committee needs experienced and professional people. Also, they need sufficient resources and time to guide the accounting, the audit, ethical value governance arrangement.

7.7 Internal Audit
The internal audit must be competent, professional, experienced and independent and sufficiently provided with resources to develop the actions for which it is responsible. The main responsibility of internal audit is to guidance of the general management for the significant organizational operations.

7.8 Performance, Commitment and Abilities
Two recent concept which have been added to accountability, performance and conformity are commitment and abilities. Commitment demonstrates the implementation of corporate governance values for those who have an interest and concern towards the organization.

Abilities refer to time duration, budget, professional training and understanding of what is needed for new commitments, for example, control self-assessment tasks.

Abilities, commitment, accountability, performance and conformity demonstrates the leadership key in ensuring an eager response towards corporate governance.

8. Characteristics of CG
Based on specialized literature, there are two approaches to CG involved parties. Firstly, authors who consider as direct shareholders. They are directly affected by organizational performance or failure. The second part considers that organizational progress or failure may be of interest. They may directly affect other shareholders, such as managers, employees, suppliers and clients. But regarding characteristics of an efficient governance system, all authors deal with optimization of relation between directors, management, all other stockholders and investors.

The existence of CG rules, the existence of a risk management system, CG Code, internal audit, external audit and the Audit Boards are the most important traits of CG.

The American model, Great Britain, German model and the Japanese model are the universal model of CG in specialized literature.

The American model is characterized by individual shareholders and domination of independent person called “outsiders” because they are not connected by the corporation through business relationships, and the dispersion of social capital to a large number of shareholders, who are commonly interested in gains, without getting affected in the corporation’s business.

Although throughout time, The German model received a series of traits of The American model, this model kept its specifics. The most crucial trait of The German model is the high concentration and care of capital, manifested in the fact that most of the stockholders...
have an active part in the management and control of the enterprise and also are connected to the organizational by mutual interest. As a result, they called “insiders”.

The Japanese model is very similar to The German model. In this model, investors demonstrated by bank organization. They get involved in its management and control and are connected to the corporation.

The American model is used in USA and the UK. In this study, I am going to provide a detailed analysis of this model.

The characteristic elements for the American corporate governance model are:

- The shareholders-directors-manager’s relations;
- The dimensions of conformity-performance-accountability;
- The corporate legislation and regulation – final accounts – ethical standards;
- The external audit;
- The Auditing Committee;
- The internal audit;
- Performance, commitment and abilities.

In the USA, financial failures in the 80s and also Watergate deal in the 70s did not remain without effects. A commission made of “the key accounting, financial and audit organisms, to develop a practice code for corporate management” was set in 1990, and after two years, in 1992, another commission “the Treadway Commission, developed a document which represents a model for efficient corporate governance, titled “Internal Control – Integrated Framework” also known as COSO was set.

Control environment, risk assessment, control activities, information and communication and also monitoring are five components of COSO model. This model also has a hierarchical structure.

Control environment refers to inferior level of the model. In this environment, organizations set objectives and standards for their control system, which include ethical value, integrity, management competence and superior management roles.

Risk assessment refers to a fundamental part of a new definition and explanation of internal audit. This concept consists of development of strategies to reduce their impact and also identification and management of risks.

Control activities refer to procedures and policies that ensure that measures are taken to make internal control system more effective and efficient.

In the context of adequate management, information and communication refer to support the organization to work efficiently. Information may come from both internal and external sources, and the operative communication ensures more efficient and effective management.

Monitoring refers to make sure of the periodic revision of internal control system and their adequate management. This step is important to ensure their ability to rightly influence the organization's operation.

9. Corporate Governance Principle

Openness, integrity and accountability are three foundational principles that set in Cadbury report in 1992 (paragraphs 3.1 – 3.2). These three principles explained as following in the Cadbury report:

9.1 Openness of the Companies

It is one of the foundational elements for the trust level. It needs to exist the business and also all those who have a concern and interest in business success. An open approach to information diffusion contributes to the effective and impressive functioning and working of market economy. It specifies the board of directors to take more remarkable measures. At the same time, this concept allows shareholders to have better check and control on companies.

9.2 Integrity

Integrity covers both completeness and direct practice. Financial reporting should be honest and present balanced picture of the state of the organizational affairs. The integrity of financial reports relies on the integrity of those persons who prepare financial statements.

9.3 Accountability

The board of directors are responsible for companies’ stockholders. Both stockholders and board of directors must play their rules in making that accountability effective. Board of directors is accountable regarding the quality of the information which they provide to stockholders. Also, stockholders are responsible for their willingness and readiness to exercise their duties as owners.

Cadbury report determines the starting point in the field of CG principles and laws. After that, other reports,
for example, in 1999 Rutterman Report, Greenburg Report, the Combined report and also Hampel Report completed the Cadbury report. Moreover, OECD in 1999, set and expanded the key principles of corporate governance as follow:

1. To make sure a sufficient framework for the effective performance and implementation of sound corporate leadership – CG framework should encourage and promote efficiency and transparency of markets, agreement with laws and rules, also segregation of duties of different management, authorities and regulations.
2. The framework of CG should facilitate the stockholders’ rights and key aspects related to ownership rights.
3. Equal dealing and treatment of all stockholders, including minorities and foreign stockholders.

9.4 Roles of Stockholders in Corporate Governance
Stockholders’ rights must be set by law or by other approved commitments. Therefore, the CG framework should knowledge stockholders’ rights. In addition, CG framework should support cooperation between stockholders and organizations for job creation, value and for supporting financially sound enterprises.

9.5 Information and Transparency
CG framework should focus, support and ensure a reliable and prompt in formation, referring to all materials issues in the organizations. For example, performance, financial situation, management and ownership of the organization.

9.6 Duties of the Board of Directors
CG framework must be set the strategic guidance of the organization. Also, effective monitoring of the management as well as the accountability of the Board in front of organization and stockholders.

10. Discussion and Analysis
As a result of the governance policy undertaken in the mid-eighties, the need was raised to strengthen public enterprises in order to become models of efficiency, fulfill the purpose for which they were created and will adhere to more strictly to the rules that govern them. This need for change gave rise to a deep process of deregulation and disincorporation of entities, as well as to privatization and thinning of the governmental structure in areas that were not considered priorities or properly inherent in the role of the State; that is why in the early nineties, state assets were transferred to individuals with the goal of significantly reducing the number of public companies. In 1982 alone there were approximately 1,200 public companies and parasternal entities; today they do not add more than 200. Public companies have an economic weight and an important social impact in the country. The political component in the administration of these bodies must be compensated with good corporate governance practices. In 2005, the “Corporate Governance Guidelines for State-Owned Enterprises” were published by the OECD, which intend to apply Corporate Governance practices to all State organizations, which would help to add value in terms of transparency, trust and credibility.

There is a false premise that corporate governance is applicable only to private companies listed on the stock exchange, seeks to ensure that state enterprises have a field of action through a clear separation of the State as owner and the role of regulatory entity, as well as allowing greater flexibility in capital structures, and reduce political interference within the administration of official entities, through the appointment of directors, in a transparent manner based on skills and abilities.

The implementing a model of corporate governance in public sector institutions means adopting a true administrative modernization in the organization, in which the Board of Directors or Governing Board focuses on the totally strategic part of the institution and not on the operative part. The Board or Governing Board must not lose sight of the fact that it is the company’s representative and must act as the primary shareholder of the assets and destinations of the public entity. The performance of this body must be based on the public interest at all times. The Center of Excellence in Corporate Governance - which points out that the incorporation of corporate governance practices in the management of the public sector significantly changes its image to project itself as a solid administration due to its efficiency and transparency. The case of the United Kingdom, where the Board of Directors of each public sector organization reports to the prime minister, who in turn reports to Parliament on a linear and ascending hierarchical management, unlike
the division of powers that stipulate equal conditions for the Executive, Legislative and Judicial Power\textsuperscript{20}.

The duty of the institutions of the public sector is to act, in the ordinary, subject to the public interest that demands results, regardless of the ideology of those who are in government in their highest hierarchies. Corporate governance in public entities constitutes a mechanism to ensure a sustained scheme of action by the public sector, in which the management of these institutions is predictable, legal and guarantees a transparent and correct procedure based on the public interest\textsuperscript{21}.

12. Conclusions

The citizen, based constitutional rights, should require corresponding authorities for the excellent management of the different entities of the public governance and the adequate performance of those who have been chosen for governing them. On the other hand, only considering the implementation of government practices, the entities of the public sector will have to compete under the same standards as the companies of the private sector which will contribute to improving economy and society as a whole.

Multinational companies have strategies to increase the profit for stockholders. Public authorities’ corporate governance has aimed at satisfying the citizens’ need and the public benefit. Through the citizen satisfaction increase, the organizational income also increases; thereby the general aim of increase in profit growth for shareholders is achieved.

If we assume citizens are shareholders of public services, taking into consideration that citizens finance services through dues to the State budget and taxes to receive quality and prompt public services, then we can conclude that the public organizations’ aim is to obtain growth in citizen profit. So, the model of corporate governance in the private sector does not differ enormously from the public sector corporate governance. Corporate governance in public should be aimed at amending and improving corporate management, transparency and responsibility, for regaining the trust of citizens.

13. References


