RISK, INTERNATIONAL STANDARDS AND CORPORATE GOVERNANCE

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Abstract - Different Corporate governance (CG) models exist throughout the world as a result of different cultural, legal and corporate (C) environments (Fraser et al, 2000). (CG) was one of the hottest topics so far due to a series of governance failures, which have increased the public scrutiny of the companies and their activities. As a result, many reports to deliver guidelines for good practice in (CG) have been issued. But, are these codes effective? and are they compatible with international standards? The assumption of this paper is that since (Bs) carry broadly similar responsibilities within whatever form of (CG) structure, governance is about (Bs) effectiveness and (Bs) accountability the world over.

Keywords - Different Corporate Governance (CG), Different Cultural, Legal and Corporate (C)

I. INTRODUCTION

The earliest consideration of (CG) was the Treadway Report (USA 1987), which concerns of internal control; while the first "full-fledged code", as professor Beck described it, was Cadbury Report. In 1992 the UK was stinging from a number of (CG) scandals and disasters, including the Maxwell Group raid on the pension fund of the Mirror Group of newspapers, the collapse of BCCI and the Polly Peck scandal. Afterwards, the Cadbury committee was established and (CG) as a "big-ticket issue" had arrived (Willis, 2002). Appendix (1) explains the evolution of (CG) in the UK from the early days of Cadbury through a series of reports, committees and published guidelines Rutteman, Greenbury, Hampel, and Turnbull in the private sector and its counterparts in the public sector.

(CG) is defined as" the system by which companies are directed and controlled" (CIMA, 1992). (Bs) are responsible for governance of their companies and their actions are subject to laws, regulations and the shareholders in general meeting, while the shareholders' role is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.

The UK has adopted a unitary (B), comprising both executive and non-executive directors. The chairman of the (Bs) is normally a non-executive director while executive and non-exclusive directors have different functions within the company; all directors have collective responsibility legally for the decision of the (Bs). But this structure is not accompanied by neither the detailed guidelines nor legal enforcement.

(CG) concerns both the effectiveness and the accountability of (Bs) of directors. The effectiveness of (Bs) is measured by performance and ultimately by enhanced shareholder value, while accountability is what provides the legitimacy to the classic model public company. Cadbury (1992) identified three key principles of (CG) as: openness; integrity; and accountability. Nevertheless, OECD refers to fairness, accountability, transparency, and responsibility as the best values of good governance. In addition, the practice of (CG) is often associated with a sound legal and regulatory framework and rules of law. On the macro scale, effective (CG) practice will ensure that investors' rights will be protected, will increase competitiveness, and attract domestic and foreign investments. In this sense, (CG) is a cross cutting theme, as a result of which stability and safety of the financial system can be assured (Yener, 2001).

II. LITERATURE REVIEW

Not only (CG) reduces risk, stimulates performance, improves access to capital markets, enhances the marketability of good services, improves leadership and demonstrates transparency and social accountability but also it goes further to national level. The World Bank's view of (CG) is that: "governance matters, … there is a strong causal relationship from good governance to better development outcomes such as higher per capita incomes, lower infant mortality and higher literacy". In addition, the importance of effective governance is essential for building confidence in public sector entities due to growing recognition that the public sector businesses must contribute positively to the national economy.

The UK's high standards of governance seem to be beneficial and there is wide acceptance of best practice in the majority of listed companies while in other European countries, (CG) is generally seen as a 'developing area'. Besides, UK governance has advantages over that of US. This is illustrated in the following aspects:

It is generally recognised that there should be a clear division of responsibilities at the head of companies to ensure a balance of power and authority (KPMG, 2002). Cadbury report stressed this virtue of having a

"clearly accepted division of responsibilities at the head of a company". Thus, the separation of the roles of chairman and (CEO) is considered as advantageous because "(Bs) appear to meet more frequently in the UK than in other European countries" (KPMG, 2002). Moreover, as Fraser et al (2000) argued that Hampel made the point that the directors' duty is to shareholders both present and future and argues for the development and sustaining of other stakeholders relationships on the ground that this will facilitate the objective of long term shareholder value. Sendt (2001) explained that while in Australia the current governance models for government businesses do not meet all essential governance criteria because there is a mismatch between their powers and responsibilities that due to that CEO appointments not being entirely controlled by the (Bs).

III. ASSESSING THE EFFECTIVENESS OF UK (CG) VS. OTHERS

The lack of good auditing could cause harm, as that which happened in (USA). Therefore, "[a]udit quality, ethics and the effectiveness of audit need to be examined" (Financial Times, 14 Nov, 2002). As Cadbury report recommended that (Bs) of listed companies set up audit committees, they are widespread in UK and contain a higher proportion of independent directors than elsewhere (KPMG, 2002). Such a report, which describes an audit and examines the major factors that contribute to audit quality, has been published by the Institute of Chartered Accountants for England & Wales (ICAEW, 2002). In Germany and Netherlands, as a consequence of the two-tier system the number of companies that have established an audit committee lags behind other European companies (KPMG, 2002). In addition, at present of the OECD countries, only Italy has mandatory auditor rotation while Brazil and Singapore have recently introduced it.

The Hampel committee drew praise for broadening the concept of control (Drennan and Beck, 2001). This is consistent with both Basel Committee on Banking Supervision and the Australian/New Zealand Standard (AS/NZS 4360), which provides a generic guide for establishing and implementing the risk management process involving identification, analysis, assessment, treatment and continuous risk monitoring.

Again, the Combined Code and Turnbull report emphases on all risks including financial and operational. Further the compliance controls and risk management have probably raised the awareness of non-financial risks within the UK. However, in all European countries other than the UK, a small minority of companies was unsure as to whether or not the (Bs) were fully aware of the significant risks (KPMG, 2002). The reason could be that internal control is largely depended on the interpretation of individual directors and companies (Drennan and Beck, 2001).

Moreover, OECD guidelines and Turnbull report have stressed the importance of IT governance "To achieve success in this information economy, enterprise governance and IT governance can no longer be considered separate and distinct disciplines"(GAMA, 2002), thus the UK internal control structure addressed BS 7799-2, as it does" ISO 9001:2000.

The Combined Code recommends that remuneration committees should consist exclusively of non-executive directors who are independent. The prevalence of executive directors on remuneration committees is far greater in Belgium and Switzerland where the recommendations are not so tightly drawn (KPMG, 2002). Further, the Greenbury Committee recommended extensive disclosure of directors' remuneration and set guidelines for determining executive pay. But in a report on compliance with the FSA's Combined Code, NAPF found that 49% of UK's top 400 companies failed to meet the recommendation that only independent non-executive directors should set directors' pay levels ((CG), 2001).

Turnbull report's primary purpose was to provide listed companies with guidance to implement the requirements in the code relating to internal control (Drennan and Beck, 2001). As a result, most UK and (German as a result of KonTraG) companies have internal audit function while Belgium, Switzerland and the Netherlands do not (KPMG, 2002). Later in US, the Sarbanes-Oxley Act of (2002) was emerged to require SEC-registered annual reports need to contain an Internal Control Report (Methodwares, 2002).

One of the OECD principles of (CG) is disclosure and transparency. The (CG) framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company. Recently the importance of disclosure of proper plans for (Bs) succession was raised in UK as well as European countries. But regarding the improved disclosure of non-audit fees, the UK's rule on disclosure of fees paid to auditors is already more comprehensive than in other EU countries, while the USA has only recently introduced rules similar to that of UK (KPMG, 2002). Although the UK situation is different from that in the US, the USA market for (C) control, manifest in takeovers provides a powerful incentive towards good (CG); these mechanisms have remained weak in the UK (Drennan and Beck, 2001). Nevertheless, it is better than those of other European countries (KPMG, 2002). Similar weaknesses stressed the existing legal and regulatory regimes. In the US, "companies are routinely delisted as a consequence of regulatory violations" (Drennan and Beck, 2001) and in Australia, "company directors and officers are

delisted and banned from holding positions on company (Bs) from anywhere between a couple of months to life" (Beck, 2002) whereas delisting is still rare event in UK. It has been suggested that, the job of policing those codes and pressuring (Bs) to adopt them lay not with the courts, but with both shareholders or through trade bodies like the National Association of Pension Funds or the Association of British Insurers (ABI).

Shareholder activism has been a major force in improving (C) performance in the USA and increasingly in the UK. Australia has recently undertaken significant steps to allow minority shareholders the right to take legal action against (Bs) members and officers (Drennan and Beck, 2001). While in the UK, neither shareholders nor government regulation appears to exert a powerful influence on companies (Drennan and Beck, 2001). On the other hand, there is some risk that a legal system, which enables any investor to challenge (C) activity in the courts, can become prone to excessive litigation (OECD, 2001). However, currently the LSE's listing rules require companies to publish a statement of compliance with the Combined Code. Yet neither the current regime, nor the new rules under the Financial Services & Markets Act 2000, gives a clear indication of possible sanctions arising from non-compliance with (CG) guidelines.

IV. THE SIGNIFICANCE OF UK (CG) CODES

Strong minority share ownership rights protection is closely associated with an active stock market (Yener, 2001). Thus, (CG) frameworks in the UK are mostly designed to promote stock market activity. In this environment, disclosure requirements are stringent, which also enhances the protection of minority shareholders.

Empirical research shows that origins of the legal systems and traditions do matter in determining the effectiveness of (CG) practice (Yener, 2001). Several authors showed that countries having common law as the origin of their legal system, such as UK, provide better protection of shareholders and creditors rights relative to countries with civil law based legal systems and traditions (Germany, Japan, other continental European or Asian countries).

Turnbull has helped raise awareness of, and established the need for risk management. Further, the increasing dependence upon more complex information systems means that more emphasis needs to be given to the information risk management element of (CG). Currently, the IA (CG) framework within the UK centres on two pillars: The Turnbull Report and British Standard 7799 Code of Practice, "Part I of which was made International Standard 17799" (IAAC, 2002). But, despite this base, UK firms have never done too much of the IT work (Financial Times, 14 Nov 2002) while in the USA, this work is traditionally the province of lawyers.

Prince as a structured method for effective project management is used extensively by the UK Government and is widely recognised and used in the both private sector in the UK and internationally. While the significance of Risk Management Standard is its compliance with the terminology for risk set out by ISO in its recent document ISO/IEC Guide 73 Risk Management.

V. CONCLUSION

The UK learned its lessons in (CG) slowly; it did come to signify best practice in the running and control of companies. The best practice in (CG) is more common in UK than elsewhere in Europe. But Europe has no overall effective system for the enforcement of best practice, while USA has a powerful enforcement organisation like the Securities Exchange Commission. It could be argued that the UK's (CG) codes could be more effective and advanced, if the practice is associated with a sound legal and regulatory framework and rules of law.

As the UK and the continental systems each have their advantages, a combined model of best practice in (CG) could be workable. The Enron situation brought the current governance -in particular auditing process- into question; this requires actions by standard setters, legislators, auditors, and other participants to review and develop UK codes by learning from others failure.

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