

THE IMPACT OF CORPORATE GOVERNANCE ON THE RESTRUCTURING OPERATIONS OF AUDITED ENTITIES

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Abstract: *The study is based on public information provided by the National Trade Register Office regarding all audited entities within the county of Cluj. In accordance with the legal provisions, the audited entities must notify, in case they meet the legal requirements, if they contract financial audit jobs. The processed information refers to the connection of the management's nature and the source of the capital for these entities with the frequency of the changes occurred in the structure of the entity and/or of the social capital. Operations of such nature, considered for the period 2005-2012, refer on one side to absorption mergers, dissolutions without liquidation followed by merger, partial divisions and transfer of the audited entity's headquarters in other counties (positive operations) and on the other side to operations of liquidation, insolvency, dissolution followed by liquidation, temporary suspension of activity for a maximum period of 3 years (negative operations). Positive operations are considered by authors to have as an impact the optimization of the indicators of financial position and/or performance, and the negative operations as those unlikely to meet the principle of activity continuity. The study aims to determine whether there is a correlation between a certain type of corporate governance on one side and the frequency of the two categories of changes in the structure of the activity and/or of the social capital. Conclusions are relevant for at least two reasons: the study is exhaustive, there have been taken into consideration all the audited entities in the county of Cluj and, moreover, the analyzed period is very expansive (the last seven financial years). On the other hand, from the previous studies it appears that within audited entities there is a higher preponderance of foreign management in comparison with a more moderate foreign investment. Relevant in this respect are the findings regarding the nature of the changes in the structure of the activity and/or of the social capital within the audited entities where there is an overlap between the foreign governance and the foreign investment.*

Keywords: corporate governance; audited entities; restructuring operations; foreign investment; social capital.

JEL classification: M41, M42

1. Introduction and Literature Review

Regardless of an entity's size or its field of activity, the management is of utmost importance in determining the manner in which an entity can use the available resources as efficiently as possible in order to achieve the intended results and to make optimal decisions in this respect. Ensuring an effective corporate governance is a relatively new aim on the list of objectives regarding international economic convergence, also as the manner in which the audit can contribute to achieving this goal. This is a topic of great interest and debate between the two academics and

practitioners or specialists (Boța-Avram, 2012). The general objectives of the audit include verifying and subsequently ensuring that within financial statements there are no assets, liabilities, or equity which do not exist or do not belong to the entity and that the accounting principles have been respected when preparing the financial statements (Oprean, 2007). Other authors' opinions regarding audit's objectives come to support the promotion of the idea of regularity, sincerity and the true and fair view of financial statements, having as field of application everything that has a key role in determining the results and establishing the financial statements (Ghiță, 2009). These aspects are complemented by the fact that financial audit is independent of management and the Board of Directors, being performed by professional accountants in order to increase the usefulness and credibility of financial and accounting information (Florea, 2011). Therefore, the users of the information provided by financial statements rely on the financial auditors' objectivity and integrity, and also on the responsibility that comes with the profession of financial auditor (Crăciun, 2002). Corporate governance includes an additional level of responsibility: external audit, which along with internal audit are considered the pillars of corporate governance (Ghiță, 2008). For effective management of any organization, corporate governance must have an adequate level of information system which gives the relevant information in order to facilitate the decision making process (Topor, 2011). A significant role is assigned to the financial auditor which contributes in providing some reasonable guarantees for investors concerning the efficiency with which management manages the economic and financial situation (Fraser and Pong, 2009). The financial auditor must provide a reasonable assurance level on the true and fair view of the financial statements and on the fact that the company's practices and accounting policies are verified and certified (Sikka et al., 2009). On the other hand, the literature consists of general information regarding the nature and sequence of foreign or local management within Romanian entities. There is a relatively low statistically fundamented amount of information concerning the business conducted in Romania, run by foreign managers, and even less, related to a comparison between foreign and local managers' efficiency. Since the relevance of the information drawn from this kind of study is subjected to considering the entities that have a significant impact on national economy, and whose financial statements present credibility (are audited), we considered appropriate to conduct the study starting from the entities subjected to external financial audit.

2. Methodology

The study is based on information submitted in September 2012 by the National Trade Register Office. They include the situation of all entities with private capital from the county of Cluj in the period 2005-2012. The data collected, processed and used in this study refers to the nature of management (foreign or local), the local or foreign participation at the social capital, the field of activity of every audited entity, and it also reveals if there were any changes in the structure of the activity and/or social capital within every one of these entities in the analyzed period. This public information was strengthened in order to analyze the effectiveness of foreign management in comparison with local management for all audited entities in the county of Cluj, based on the changes in the structure and/or social capital developed

during the last 8 years. A high frequency of such operations can have different meanings:

- positive (the operations aim to optimize the indicators of financial position and/or performance as a result of the activity subsequently developed by these entities): absorption mergers from the absorbent entity's perspective, dissolutions without liquidation followed by merger from the absorbed entity's perspective, partial divisions and transfers of the audited entity's headquarters in other counties.
- negative (the operations meet or are unlikely to meet the principle of activity continuity): liquidations, insolvencies, dissolutions followed by liquidation, temporary suspension of activity for periods up to 3 years.

Entities with foreign management were considered those entities which in the analyzed period had chosen individuals with foreign citizenship and/or legal entities associated with individuals with foreign citizenship to fulfill certain attributions, as administrators, chairman of the Board of Directors or member of the Board of Directors. The inclusion in the study in an exhaustive manner of all audited entities (in accordance with the records of the National Trade Register Office) and their monitoring for a sufficiently long period of time (8 years) confers relevance and rigor to the information drawn from the analysis of data processing.

The interdisciplinary nature of the study confers relevance to the research results. Interdisciplinarity emerges from notions related to general economy (approach of the local and foreign investments), accounting (notions related to audited entities, changes in the structure of the activity and/or social capital) and management (correlation of such data with the type of corporate governance: foreign or local). The study has significant practical implications for it reveals the dynamics of audited entities' evolution by reference to the frequency of changes in the structure of the activity and/or social capital (of positive or negative nature). This way, one could shape an overall image on the stability of the audited entities' activity, and on the perspective of activity continuity and future evolution of the audit market.

3. Results and Discussions

Foreign management can be identified in a significant number of audited entities in the county of Cluj (28.29%), and the percentage of audited entities which have experienced changes in the structure and/or the social capital exceeds one third (35.85%) of the entities subjected to financial audit activities in the period under consideration.

Table1: Distribution of audited entities correlated with the nature of management and changes in the structure and/ or the social capital

Explications	Foreign management	Local management	Total
Audited entities which have experienced changes to the structure and/or social capital	45	64	109
Audited entities which have not experienced changes in the structure and/or social capital	41	154	195
Total number of audited entities	86	218	304

Source: Statistical processing performed by the authors

The percentage of audited entities which have experienced changes is lower in the case of audited entities with foreign management (41.28%) than those with local management (58.71%). The same report of inferiority is maintained in the case of audited entities which have not registered modifications, having foreign management (21.02%) compared to those with local management from the same category (78.97%). Because the percentage of entities with foreign management is lower within the total of audited entities, it shows significance the assessment of the changes occurred in the structure and/or social capital, using the nature of management as the main criteria.

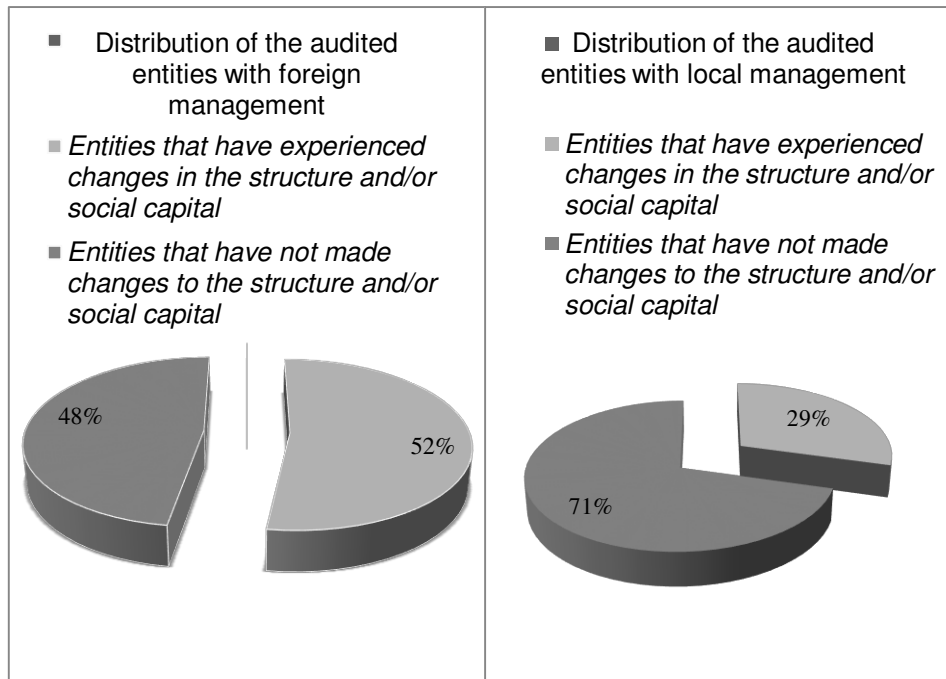


Figure 1: Distribution of audited entities according to the nature of management
Source: Statistical processing performed by the authors

The audited entities with foreign management experienced changes in proportion of 52%, while a lower percentage of 48% did not experienced any changes in the structure and/or social capital according to figure 1. Regarding audited entities with local management the situation is different, as the percentage of those which experienced changes is lower than 29% in comparison with the percentage of entities which did not registered any changes. Therefore, audited entities with foreign management present a tendency with 79% higher than those with local management towards changes in structure and/or management. This result reveals the fact that audited entities with foreign management manifest superior dynamics in terms of adapting to economic conditions: they either experience changes which improve the financial position and performance, or these changes aim to reduce the losses of capital invested in distressed activities by terminating or reducing the activity. In

order to deepen the study and to obtain information regarding the nature of these changes, one has made a correlation of the obtained information with:

- foreign or local participation to the social capital;
- the specific field of activity of every audited entity: production, services or commerce;
- the existence or absence for every situation (in the analyzed period) of certain changes to the structure and/or social capital, and also the nature of these changes.

3.1. The Structuring of Audited Entities With Foreign Management

If, for the period under consideration, we approach the audited entities with foreign management in more detail according to the size of foreign investment to the social capital, the field of activity (production, services, commerce) and the nature of change operations in the structure of the activity and/or social capital, we obtain the following distribution:

Table 2: Distribution of audited entities with foreign management

Type of management		Foreign management													
Structure of social capital		With foreign participation to the social capital							Without foreign participation to the social capital						
Field of activity		Prod		Serv		Com		Total	Prod		Serv		Com		Total
Number of entities		Yes	No	Yes	No	Yes	No		Yes	No	Yes	No	Yes	No	
		6	12	12	9	0	4	43	1	6	26	7	0	3	43
Type of change	Insolvency	2	-	2	-	0	-	4	1	-	0	-	0	-	1
	Liquidation	0	-	1	-	0	-	1	0	-	0	-	0	-	0
	Absorption merger	0	-	1	-	0	-	1	0	-	0	-	0	-	0
	Partial division	0	-	0	-	0	-	0	0	-	0	-	0	-	0
	Dissolution without liquidation-merger	0	-	1	-	0	-	1	0	-	25	-	0	-	25
	Dissolution followed by liquidation	1	-	3	-	0	-	4	0	-	0	-	0	-	0
	Temporary suspension of activity	0	-	0	-	0	-	0	0	-	0	-	0	-	0
	Transfer of headquarters	3	-	4	-	0	-	7	0	-	1	-	0	-	1
	Total changes	6	-	12	-	0	-	18	1	0	26	-	0	-	27

Source: Statistical processing performed by the authors

The audited entities with foreign management experienced changes in proportion of 41.28% in the period 2005-2012. Correlated with the existence of foreign investment, one can identify the following situations:

a) Audited entities with foreign participation to the social capital

The entities from the service sector experience a higher frequency of changes in structure and/or social capital. Thus, from the total number of entities with foreign management and foreign participation to the social capital which have registered changes, 66.67% are entities with activities belonging to the service sector (percentage of 3.95% from the total of audited entities included in the study). The percentage of entities from the service sector which experience changes in structure and/or social capital of positive nature is of 50% (absorption mergers, dissolutions without liquidation followed by merger, partial divisions and transfers of the audited entity's headquarters in other counties).

The commerce sector is the most stable in terms of changes in structure or activity of the entities included in the study.

b) Audited entities without foreign participation to the social capital

The audited entities from the service sector gather a percentage of 96.3% from the total of changes in the activity's structure experienced by the entities with foreign management and without foreign participation to the social capital (percentage of 8.55% from the total of audited entities included in the study). All these entities have exclusively recorded in the analyzed period operations considered to be of positive nature. Regardless of the structure of the social capital, the audited entities from the commerce sector did not experience any operation of insolvency, liquidation, merger, dissolution, suspension of activity or transfer of headquarters in the analyzed period.

The incidence of insolvencies within the audited entities with foreign management is of 5.81%, being higher in the case of those with foreign participation to the social capital (9.3%) in comparison with those which do not record foreign participation to the social capital (2.33%). In contrast, one can notice within the latter category a high frequency of dissolutions based on the absorption performed by the absorbing entity as a result of the process of absorption merger (92.59%). On the other hand, within the entities with foreign management and foreign participation to the social capital, there is a higher frequency of dissolutions followed by liquidation (22.22%) and of transfers of headquarters in other counties (38.89%) by reference to the overall changes in the entities' structure and social capital.

The systematization of these operations of positive nature (absorption merger, dissolutions without liquidation followed by merger, partial divisions and transfers of headquarters) and of negative nature (liquidations, insolvencies, suspensions of activity), depending on the estimated impact that it would have on audited entities, it provides a centralized image of their frequency in the period 2005-2012.

3.2. The Structuring of Audited Entities With Local Management

The audited entities with local management, both those with and without foreign participation manifest a higher tendency to experience changes in the structure and/or social capital (58.72%) in comparison with the entities with foreign management (41.28%). The detailed results of the study are highlighted in the following summary:

Table 3: Distribution of audited entities with local management

Type of management		Local management													
Structure of social capital		With foreign participation to the social capital							Without foreign participation to the social capital						
Field of activity		Prod		Serv		Com		Total	Prod		Serv		Com		Total
Number of entities		Yes	No	Yes	No	Yes	No		Yes	No	Yes	No	Yes	No	
		0	2	2	7	0	0	11	6	34	49	97	7	14	207
Type of change	Insolvency	0	-	0	-	0	-	0	4	-	2	-	1	-	7
	Liquidation	0	-	0	-	0	-	0	0	-	2	-	0	-	2
	Absorption merger	0	-	0	-	0	-	0	0	-	0	-	0	-	0
	Partial division	0	-	0	-	0	-	0	0	-	2	-	0	-	2
	Dissolution without liquidation -merger	0	-	1	-	0	-	1	1	-	24	-	1	-	26
	Dissolution followed by liquidation	0	-	1	-	0	-	1	1	-	7	-	4	-	12
	Temporary suspension of activity	0	-	0	-	0	-	0	0	-	4	-	1	-	5
	Transfer of headquart.	0	-	0	-	0	-	0	0	-	8	-	0	-	8
	Total changes	0	-	2	-	0	-	2	6	-	49	-	7	-	62

Source: Statistical processing performed by the authors

a) Audited entities with foreign participation at the social capital

The audited entities with local management and foreign participation experience the lowest percent of changes, namely 0.66% from the total of entities included in the study. Similar to the previous situations, these changes in the structure and/or social capital are registered in the period 2005-2012 by the audited entities from the service sector. The proportion of positive and negative changes is equal, each one quantifying a rate of 50% from the total of changes related to these entities' activities. Therefore, in terms of frequency regarding changes in the structure and/or social capital, the audited entities with local management and foreign participation to the social capital are the most stable, especially those from the commerce and production sectors which did not experience any kind of change during the eight years under consideration.

b) Audited entities without foreign participation to the social capital

The audited entities with local management and without foreign participation to the social capital experience the highest frequency of changes in the structure and/or social capital, namely 96.88% from the total of audited entities with local management and 20.40% from the total of audited entities included in the study. If we observe the results of the study for this type of entities taking into consideration their field of activity, it appears that the highest frequency of changes was recorded

in the service sector (79.03%), and the sectors of production and commerce have showed a greater stability in terms of changes (about 10% each).

This detail reveals that such entities which register a high frequency of changes, they either encountered significant difficulties from the perspective of business continuity, or they reorganized themselves in order to improve their activity, action imposed by the difficult economic and financial conditions. In order to highlight the trend, it is relevant to analyze the type of change experienced in the period under consideration by every audited entity with local management and without foreign participation to the social capital. In this situation (audited entities with foreign management and without foreign participation to the social capital), the changes of positive nature (absorption mergers, dissolutions without liquidation followed by merger, partial divisions and transfers of the audited entity's headquarters in other counties) have registered a high frequency (58.06%).

The frequency of insolvencies in the period of time 2005-2012 within the audited entities with local management is of 3.21%, lower than the frequency of insolvencies within the audited entities with foreign management. One can observe within these entities both a necessity and also a high ability of reorganization, emphasized by the high frequency of positive operations, of changes in the structure and/or social capital in general, and also of the dissolutions without liquidation followed by merger in particular (these entities represent 42.19% from the total of changes registered within this sub-category, respectively 12.56% from the total of entities with local management and without foreign participation to the social capital).

3.3. The Typology of Corporate Governance Decisions

The centralization and correlation of the study's parameters (nature of management, foreign investment, field of activity - production, services, commerce - and also the preponderant typology of changes in the entity's structure and/or the social capital) facilitates the process of relatively emphasizing the manner in which corporate governance has reacted in the period 2005-2012 concerning the management of the analyzed entities, namely:

- defensive managerial decisions, of adaptation to the difficult economic and financial conditions sustained by a high frequency (for a certain type of management and field of activity) of the following operations: merger, liquidation, insolvency, dissolution, suspension of activity and transfer of headquarters to another location;

- offensive managerial decisions to increase the audited entities' performance, emphasized by the high frequency of the operations of positive change in the structure and/or social capital: absorption mergers, partial divisions, dissolution without liquidation followed by merger, transfer of the entity's social headquarters to another location;

- neutral management policies, of maintaining the audited entities' stability, highlighted by a relatively small number of decisions aiming operations of change in the structure and/or social capital previously mentioned;

- a relatively low incidence of insolvencies;

Table 4: The typology of corporate governance decisions of the audited entities in the light of changes in the structure and/or social capital

Parameters	Foreign management						Local management					
	With foreign participation to the social capital			Without foreign participation to the social capital			With foreign participation to the social capital			Without foreign participation to the social capital		
	Production	Services	Commerce	Production	Services	Commerce	Production	Services	Commerce	Production	Services	Commerce
Defensive decisions, ability to adapt to difficult conditions (high frequency of operations)		x			x			x			x	
Offensive decisions, to increase the performance (high frequency of positive operations)		x			x			x			x	
Neutral managerial policies which aim the activity's stability (relatively low frequency of operations)			x			x	x		x			
The relatively low incidence of insolvencies			x		x	x	x	x	x			

Source: Statistical processing performed by the authors

4. Conclusions

After analyzing the previously centralized data, one can draw some estimations regarding the audited entities' tendency concerning their activity, based on the corporate governance decisions. The audited entities belonging to the production sector experience the lowest frequency of operations such as those previously mentioned, except the audited entities with local management and without foreign participation to the social capital. Thus, regardless of the management's nature and the existence or absence of foreign investment, the audited entities from the service sector had the higher dynamics in terms of management decisions regarding operations which aim to change the structure of the activity and/or the social capital:

- in this sector, there are both defensive decisions (high frequency of all operations) and offensive decisions (higher frequency of the operations considered of positive nature);

- from this point of view, the aggregate evolution of these entities' performance can be mixed: performance increase for some entities, but also decrease for others;

- starting from these premises, the corporate governance decisions aim either to diminish losses and come with efficiency measures, or to increase the

performance indicators and less likely to constantly maintain the financial and economic parameters that measure performance;

-insolvency has a lower incidence than the production sector and higher than the commerce sector.

In general, audited entities from the commerce sector have a relatively low frequency of changes in the structure of activity and/or social capital. It is significant that insolvency has the lower incidence within this field of activity. The decisions to increase the performance through the high frequency of positive operations are specific to the service sector, these being adopted equally by the foreign or local management, regardless of the nature of participation to the social capital. The largest number of insolvencies is reflected within the audited entities with local management and without foreign participation to the social capital.

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