THE ROLE OF ADVISORY COMMITTEES IN THE SYSTEM OF THE CORPORATE GOVERNANCE. CASE STUDY ON LISTED COMPANIES IN ROMANIA

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Abstract:
Corporate governance concerns the way in which companies are managed and controlled. For efficient management of companies, these are recommended either to use the dual system of management, which, implicitly, assumes a board independent, supervisory board, respectively, or to establish independent advisory committees. Studies over time have shown that it is necessary to increase the role of BD and the establishment of specialized committees to advise the Board in its work. This study attempts to show, first, the need for advisory committees in addition to BD, with emphasis on the global situation. Second, to analyze is the situation and functioning of these committees at national level, we performed an empirical study of companies listed on the Bucharest Stock Exchange on tier I.

Key words*: corporate governance, advisory committees, audit committee, remuneration committee, nomination committee.*

JEL classification: *G34, G38, M48, N40*

In time, *corporate governance* has been defined in different ways, but essentially is the same conceptual dimension. Thus, *broadly*, CG is considering the way in which companies are managed and controlled (OECD 2004). *More specifically*, the CG system concerns the distribution of rights and responsibilities between various stakeholders on a particular company, such as board of directors, managers, shareholders and other stakeholders (employees, customers, suppliers, creditors, investors, state and community in general) and state rules and procedures for making decisions on corporate affairs.

Central pillar in the system of Corporate Governance is *the Board of Directors* and its ability to create long-term value by balancing the interests of all stakeholders. In 2004 (Kuhndt et al) is emerging concept: *Responsible Corporate Governance* (RCG). RCG is defined as *a policy focused stakeholders to allocate responsibilities to social actors, in turn, will lead the company with responsibility*. In order to achieve this goal, corporations must comply with several *principles*, namely: accountability in corporate governance; identify clearly and specifically, social values, environmental and economic, in accordance with the requirements of stakeholders; establishment of priority action areas: social, environmental and economic; adoption of certain management practices to integrate those values into the company's operations; presentation of the impact of social action, environmental and economic effects on business and society in general; exhaustive analysis of activities undertaken considered areas of interest; making efforts for lifelong learning.

In addition, the company believes that good governance alone can not make an organization successful. To achieve this goal, a company must follow three dimensions, namely: *performance, compliance and corporate responsibility* (Fahy et al, 2005). An important role in ensuring the three dimensions is owned by BD. In recent years, the Board of Directors advice and assistance are provided by several independent committees, including the most important are: *the audit committee, remuneration committee and nomination committee (selection).*

1. Need for advisory committees and global situation

Establish independent committees were a trend first developed *in the Anglo-American*, but quickly spread in *European countries*. Data on large listed companies indicates that the audit committee is already established in all European countries. 66% of European companies have *an audit committee*. If at least one committee is created, in 74% of cases it is *the audit committee*. Number of *remuneration committees* has increased substantially over 60%. 62% of European companies have a remuneration committee. Even smaller companies have started to work the remuneration committee. Nomination Committee is not so frequently encountered. However, in 47% of European companies are such committees (Van den Berghe, L. et al., 2002).

More specifically, the existence of specialized committees within the Board of Directors, presented compared to two systems: the Anglo-Saxon and continental (are selected the most representative countries of the two systems), can be seen in the table below.

Table no. 1 *The presence of advisory committees in CA (%)*

Board of Directors with:	**USA**	**Great Britain**	**France**	**Germany**
Audit committee	100	88	87	28
Remuneration committee	99	89	90	19
Nomination committee	74	54	20	17

Source: Richard, B., Miellet, D., (2002), by Onofrei, M., (2009)

We note that the U.S. presence is 100% independent committees (for audit committees) or very close to that percentage (for other committees), while in Germany, the presence of specialized committees to advise the board is quite insignificant. In the continental system, is remarkable, however, France, with a significant presence to advisory committee in the Board of Directors. Lowest percentage is owned by the remuneration committee; In France and Germany, only two out of ten companies have such a committee.

So the establishment of independent committees is not mandatory, but their advisory role is very important to support of the Responsible Corporate Governance and can be inferred with regard to the responsibilities incumbent upon their own.

Audit committee need arose because of requests from large companies in order to clarify certain matters of public interest. For example, companies L'Oreal and Carrefour had to request a formal point of view of the audit committee to clarify some aspects of ethics Stock. Then, audit committees are launching calls of proposals for the selection of independent auditors. Specifically, audit committees support the Board in monitoring of compliance the qualitative characteristics of financial reports surrounding public companies.

Remuneration and nomination committees have a range of tasks including: establishing explicit criteria for the remuneration of individual team managers; information on the remuneration policy in the company's Corporate Governance Rules; the selection of team members working around the President; presentation of concrete tools for performance evaluation of the President and directors; updating of professional skills of board members; presentation of the relationship between pay and performance made by the management team made. There are several limitations in the work of the nomination, meaning that it can not occur in the appointment of successor for chairman of the company, because there is already a plan for success in this regard which excludes consultation of the Committee.

If we consider the independence of members of three committees, we find that in the Anglo-Saxon (represented by the U.S.), it is more pronounced than in the continental system (represented by France). Concrete situation can be seen in Table 2.

Table no. 2 *The independence of advisory committee members*

Elements	Audit Committee		Remuneration Committee		Nomination Committee	
	USA	France	USA	France	USA	France
The average number of members	4	3	3	3	3	3
Membership management related	0	1	0	0	0	2
The number of independent members	4	2	3	3	3	1

Source: Richard, B., Miellet, D., (2002), by Onofrei, M., (2009)

It is noted in the situation that the U.S. all members of advisory committees are independent, not involved in operational activities. Not the same situation we find in France, where only members of the remuneration committee are 100% independent.
With the annual membership meetings of advisory committees, we find that the U.S. can get even five meetings per year (for the remuneration committee), while in France, within three (for the audit committee) as presented in the table below.

Table no. 3 *Frequency of annual meetings of advisory committees*

Committee	The average number of annual meetings	
	USA	France
Audit	4	3
Remuneration	5	1
Nomination	3	1

Source: Richard, B., Miellet, D., (2002), by Onofrei, M., (2009)

Romania used quite late in adopting a code of good practice in corporate governance, being driven, in particular, the privatization process, but also the transfer of control and surveillance of political organizations by the Board of Directors (BD). Adoption of codes of corporate governance is necessary to harmonize internal business requirements of a functioning market economy. In addition, the CEE countries, the European Commission adopted an action plan announcing measures to modernize company law and enhance corporate governance. Romania takes steps in this direction by amending the Company Law, and other regulations, although the practice does not necessarily keep pace with the requirements.

2. The Advisory Committees in Romania. Case Study

In Romania, the amendments to the Company Law in **2006**, updated in **2007**, include an article stating that: „Board of Directors ***may create*** advisory committees composed of at least *two members* and responsible for deployment of investigations and making recommendations to the Board in areas such as *audit, remuneration* of directors, managers, auditors and staff and *nomination* of candidates for various positions of management. Committees will submit to the Board, regularly reports on their activities. At least one member of each committee should be created independent non-executive director. Audit Committee and Remuneration Committee shall consist only of non-executive directors."

Bucharest Stock Exchange also recommended by the BSE CG Code of **2008**, its work, the Board of Directors to have the support of *independent advisory committees* for consideration of specific issues and advice on these topics.

In addition, since 2008 (GEO 90/2008), was included in national regulations establishing ***mandatory*** *audit committees, but only by public interest entities*[*]. The normative act provides that at least one member of the audit committee must be independent and have competence in accounting and/or audit. It is noted the similarity with the French system in this regard. Specifically, the audit committee *responsibilities* specified in the law aims: *to monitor the financial reporting process; monitoring the effectiveness of internal control, internal audit and risk manage people within the entity of public interest; statutory audits of financial statements monitoring; verification and monitoring the independence of the statutory auditor or audit firm*. In addition, it is noted that for public interest entities, the proposal made by the Board concerning the appointment of statutory auditors is based *on the recommendation of the Audit Committee*. In turn, the statutory auditor of the audit committee will report the key issues related to the engagement, and significant deficiencies found during internal control evaluation system.

Notice the trend shown, that the establishment of specialized committees to advise the Board in our country was first *recommended*, and later to become *mandatory* for public interest entities, but only in respect of the audit committee. Against the French, the recommended number of committee members is at least two, to be non-executive directors for both the audit committee and the remuneration committee.

To demonstrate the practical situation is currently in Romania on *the existence and functioning of advisory committees*, we performed an empirical study taking into account the companies listed in the Bucharest Stock Exchange on tier I. We assumed that in accordance with the BSE CG Code of 2008, companies whose financial instruments are traded on the regulated market operated by the Bucharest Stock Exchange to adopt and conform ***voluntarily*** with the Code of Corporate Governance issued by the Bucharest Stock Exchange. In this sense, “issuers” are required to enclose the Annual Report, starting with the year 2009, “*Corporate Governance Compliance Statement*" – “*Comply or Explain Statement*“ (CES). This statement is designed from the 19 principles included in the BSE Code of Governance which in turn are developed 38 recommendations, according to the Code Implementation Guide prepared by the Institute of CG of the Bucharest Stock Exchange, which offers suggestions for implementation according to best international practices. The main "preoccupation" CES aims to balance between executives and non-executive (independent) so that a person or group of people can not dominate, in general, the BD decision. Moreover, corporate governance quality, the Bucharest Stock Exchange recommended that work, that they may have the support of *independent advisory committees*. Checking the establishment and functioning of such committees is based on “*Comply or Explain Statement*” that contains several sections relating to advisory committees, as can be seen in the following table.

Table no. 4 *Extract from „Comply or Explain Statement”*

Principles/Recommendations	**Content**
Principle no. 10	*There is a Nomination Committee in the company?*
Recommendation no. 21	*BD review, at least once a year, need to set up a Remuneration Committee to board and to executive directors?*
Recommendation no. 22	*There is a Remuneration Committee consisting exclusively of non-executive directors?*
Recommendation no. 27	*There is in the company an Audit Committee?*
Recommendation no. 29	*The Audit Committee is composed exclusively of non-executive directors and has a sufficient number of independent directors?*
Recommendation no. 30	*The Audit Committee meets at least two times a year, these meetings were devoted to the preparation and dissemination of results to shareholders and the public?*
Recommendation no. 31	*The Audit Committee makes recommendations as the selection, appointment, re-appointment and replacement of the financial auditor and its remuneration terms and conditions?*

Source: http://www.bvb.ro/info/Rapoarte/Diverse/Comply%20or%20Explain%20Statement.pdf

Declaration of conformity was the main source from which we extract information about the existence and functioning of advisory committees at companies with securities listed on the Bucharest Stock Exchange on tier I. Of 18 companies listed in this category, four companies do not provide on their websites information about these committees, so the analysis was performed on a sample of 14 companies. We present in table below state advisory committees for the companies studied.

Table no. 5 *Advisory committees for listed companies on BSE on tier I*

No	Company	Audit Committee	Remuneration Committee	Nomination Committee
1	Alro SA	*		
2	Antibiotice SA	*	*	*
3	Azomureş SA			
4	Carpatica SA	*	*	*
5	Banca Transilvania SA	*		*
6	Biofarm SA	*		
7	BRD GSG SA	*	*	
8	Transelectrica SA	*	*	
9	Impact SA			
10	Oil Terminal SA	*		
11	OMV Petrom SA	*		
12	Ropharma SA	*		
13	Transgaz SA	*	*	*
14	Socep SA			

Source: public companies' reports on their websites

Starting from the situation presented in the table above, its findings are quite interesting in that:

- three companies say they have not an Audit Committee (Azomureş SA, Impact SA Socep SA) despite its obligation to set up since 2008 (see GEO 90/2008);
- only in five companies operate a Remuneration Committee, taking the decision to establish three companies by 2011 (Alro SA, Oil Terminal SA, Ropharma SA);
- Regarding the Nomination Committee, only four companies have questioned its establishment (Antibiotice SA, Carpatica SA, Banca Transilvania SA, Transgaz SA).

From studies, it concluded that the existence of advisory committees of the Board of Directors in Romania is presented as the chart below:

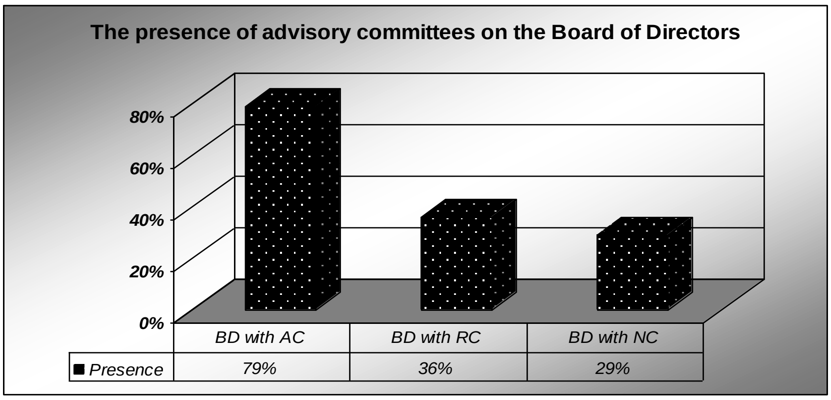

Chart no. 1 *The presence of advisory committees on the Board of Directors in Romania*

We believe that the lack of remuneration and nomination committees is because their establishment of is not an imperative issue, the only recommended. Where there is no remuneration committee and nomination, the Board is fulfilling their responsibilities. Regarding remuneration, the General Shareholders Meeting decides remuneration of the Board and Board of Directors decides the remuneration of executive management.

In addition to advisory committees mentioned, some companies have set up other committees, according to the needs. It is, first, the banking financial institutions, such as: BRD, Carpatica SA, Banca Transilvania SA, which established various monitoring committees and risk analysis, but other companies such as: Transelectrica SA (Energy Security Advisory Committee) and Transgaz SA (Safety and Security Committee and the Committee on the progress of procurement activities and services produced).

Conclusions

Although in practice there are gaps in the functioning of specialized committees, though it may be noted that once help ensure a better representation of shareholder interests, certainly the existence of these committees is an element of progress on corporate governance. In addition, specialized committees come to meet the owners and managers by ensuring the integrity of company assets.

We believe that the establishment of advisory committees to the Board of Directors is considered imperative, if we consider at least the following reasons:

- *Audit Committee* shall make recommendations to the BD for the selection, appointment, reappointment, replacement financial auditor and its remuneration conditions and monitors independence and fairness to the financial auditor; very important issues if we consider that a series of financial scandals and competition appeared less independent auditors;
- *Remuneration Committee* developing the remuneration policy for directors and executives and presents in the annual report the total amount of direct and indirect remuneration of directors and managers; important for auditors to identify risk factors for the development of fraud;
- *Nomination Committee* evaluates the overlapping of skills, knowledge and experience to the Board and contributes to updating of professional skills of its members; significant issues for the application of best practice corporate governance.

However, there are deniers of the existence of such committees, because the actions of the Board and committees would not be harmonized and, moreover, would have affected the ability of the board's control. Worse yet if this committee would be established only as a screen and practices would be "creative" of BD, and stakeholders should make decisions based on less real information. We support the idea of setting up and operation of such advisory committees in addition to BD, and pulled the alarm on Romanian companies aimed at taking into account the recommendations and codes of good practice, not just binding legal provisions.

Notes

[*] *The public interest legal means: credit institutions; non-banking financial institutions, defined according to legal regulations, entered in the register; insurance, reinsurance and insurance-reinsurance companies; entities authorized, regulated and supervised by the Supervisory Commission of Private Pension System; financial investment companies, investment management companies and collective investment undertakings authorized / approved by the National Securities Commission; companies whose securities are admitted to trading on a regulated market; companies and national companies; legal persons belonging to a group of companies and enter into the consolidation by a parent applying International Financial Reporting Standards.*

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