

PROCEDURES AND METHODOLOGIES FOR THE ADOPTION AND IMPLEMENTATION OF THE CODE OF CORPORATE GOVERNANCE

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ABSTRACT

The authors proposes in this column a brief overview of the concept of a fully designed software application that aims to implement the Corporate Governance Code at all levels of large company.

Here they are stressing the importance and the details of the state of the art technology and concepts on how to Adopt, Implement and Evaluate the Corporate Governance Code in practice and what the benefit of challenges of this implementation might be.

Key Words: Corporate Governance Principles, Management and Organizational Performance Evaluation, Scoring Assessment, Key Performance and Trend Indicators, Corporate Behavioural Valuation

1. HISTORY

The issue of adopting a Corporate Governance Code to regulate both the activity and management responsibilities of a public company has its roots in the 16-17 centuries once the East India Company, Hudson's Bay and the Levant have been established..

The adoption of the Corporate Governance Code existed in various forms over the years but only in the 70s the idea of adopting and implementing the Code in public companies listed in the United States was reactivated.

The term "Corporate Governance" came in vogue in 1976 with its first official record in "The Federal Register" and was routinely used at that time by the U.S. SEC (Security and Exchange Commission).

The term became a study and discussion issue for stock market regulators, academics, public company's management and both retail and institutional investors.

The need to adopt and implement the Corporate Governance Code at a professional level became current only at the beginning of the last decade when the first financial scandals caused by the collapse of major multinational companies as Enron, WorldCom, Parmalat, Tyco, Swiss Air and other, took place.

Although corporate governance principles existed in various forms over the time, they were implemented and used in formal reports but the conclusions contained gaps in evaluation

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analysis, correlation and monitoring fundamentals, having difficulties to find efficient feedback solutions.

A lot of companies listed on stock exchanges with a miscellaneous shareholder structure (more or less investment literate) consider adopting corporate governance rules complicated, because it requires both the amendment of the Company Statute and the implementation of the Code is inducing a well controlled surveillance system, fine-tuned to provide transparency and details about company, which is not always well interpreted, accepted and applied into the day-by-day practice.

The changes would, among other things, respect, fair treatment of all shareholders, a sufficient communication and transparency regarding key performance indicators and the company's management conduct.

Worldwide, companies are not required to apply the Corporate Governance Code to get listed on the stock exchange but the adoption and implementation of the Code is a necessity, capital market law being made in most cases by directives that refer to a good Corporate Governance Code.

In this column will attempt to describe the approach, principles, structure and implementation of this Corporate Governance report model, aiming to present methodologies and action that has to be taken, their evaluation, quantification, result interpretation and their use in order to improve corporate current activity to plan objectives to be attained and as consequence to increase company's market value.

2. GENERAL VIEW

Finding a general model of the Corporate Governance Code is difficult if we want it to work in all countries and all types of companies or industries.

One can imagine the Corporate Governance Codes used in various versions named usually as "best practices" that are considering different legislation, board structure, the business specific structure, the business environment for each country and so on.

OECD mentions a number of basic principles of Corporate Governance, generally valid when drawing scoring system for assessing the implementation of the Corporate Governance Code in a company:

- Objectivity
- Transparency
- Responsibility

These principles underlie the methodology of an evaluation model, which implements the Code of Principles and Corporate Governance system.

The methodology for establishing and implementing a scoring for Corporate Governance, is based on "Standard & Poor's Corporate Governance Scores - Criteria Methodology and Definition" as well as a rich bibliography regarding expert models on corporate evaluation's scoring methods and analytics.

3. ADOPTION OF THE CORPORATE GOVERNANCE CODE

Before implementing the Code we have to draw the *specifications* on the business environment framework, conformity and certification rules, corporate procedures and working flows (operational, support, informational, financial, decisional) of the Code and then finally adopting the Code's established principles and algorithms.

During the first stage, when establishing the framework where the Code works and can be applied, we do have to make a highly explicit and detailed description on:

- *Limitations* or situations not covered by the application of the Code
- *Exceptions* / exemptions from these limitations
- *Defining limits* of what works and do not function when applying the Code and determine the area within, the Code can be applied to and its principles preserve all designed functionalities.

The next step, in adopting the Code is the *compliance certification* process on rules and procedures described by the Code and requires verification and compatibility of all rules and procedures that will be part of the Code with the existing company's industry benchmarks accordingly the instructions developed by the financial market supervisor and other regulators.

This certification of compliance includes:

- Harmonization (through adaptation restriction and expansion) of the rules and procedures that has to be adopted in the Code (both those in use and those that will be further adopted in the Code) issued by the competent authorities
- Compatibility of company's rules and procedures with industry's standards
- Certification of compliance with all rules and procedures that have to be adopted in the Code with the specialized company's staff and if necessary with support from external consultants, usually assistance of the Corporate Governance audit at one of the Big Four auditors is highly required.

This certification process, validation rules and procedures that have to be adopted in the Code should be certified periodically (each chapter by timely business cycle or the latest update based on occurred events) but generally, the entire Code is recommended for at least one annual certification.

4. THE CODE

The Code requires the establishment of a professional highly skilled team in adopting the rules and procedures that are part of it and than the ability of this team to issue collective decisions based on the obtained assessment results (it is supposing a permanent utilization and surveillance of the Code functionality in company's day-by-day activity).

In the adopting process of the Code it is necessary to establish a working group / class of competent authorized personnel and an External Partnership that aims to contribute with complementary expertise to continuously adapt the Code to the existing business changing environment and company's financial targets.

The External Partnership refers to an external consulting team that has to be mutually agreed with the company's personnel that is in charge of monitoring and enforcing the Code.

If there is no need for certification or compliance of permanent / periodic processes and procedures of the Code, establishing an External Partnership is not required (mostly used on industries / companies that are not regulated externally by authorities and do not have much to certify and go through compliance evaluation process)

5. THE IMPLEMENTATION OF THE PROVISIONS OF THE CODE AND ITS FRAMEWORK

Once adopted, the Code document is underlying the proper functioning of processes and business of the company and is necessary to develop a guideline document or *User Manual* to make it available to all company's employees.

This *User Manual* specifies in essence methodologies by which the provision of the Code was adopted with references in the previous paragraphs of this column.

One or several appendixes is necessary to be updated periodically or whenever become necessary, is nominating specific responsibilities, skills and associated job descriptions for all company's employees.

The *job description* is an important correlation element between the Code and the provisions adopted to draw the functionality on the Company's current workflow.

The better the correlation is done, the easier to follow the Code implementation in to practice and do a more accurate assessment of its use is.

In other words, an accurate and simple job description is combining into a single document both the requirements adopted in the Code and the functions and procedures that every employee goes through the current workflow to achieve goals both at department and company level.

The job description will have a standardized configuration for all departments whether they are directly or indirectly generating financial performance and a brief and concise description of all day-by-day tasks and responsibilities is allowing consequently an easy computer programming.

Translating the Code requirements in skills and responsibilities associated to the personnel and further on, into processes and activities that can be measured and evaluated (in order to emphasize the Code and personnel contribution to achieving the objectives) is a very important and difficult operation of which depends the correct functioning of the entire assessment system, implementation and adjustment - readjustment within the Code having always at the end an impact on company's financial performance.

Further steps to be completed in this stage can be described as follows:

- Correlating the Code competencies and responsibilities to the associated and representative personnel
- Rewriting the job descriptions in respect for the provisions of the Code requirements
- Linking processes and current company's activities to the personnel's competencies and responsibilities
- Redrawing the harmonization between the Code provisions and the job description into one job description that should include all necessary information for a smooth running of the Code implementation in the company's current activity.
- Written feedback by each employee in order to evaluate their activities, processes and procedures carried out (partially or fully) daily, weekly, monthly, quarterly and annually, depending on the specific workflow structure of the consequently department.

6. WORKING METHODOLOGIES AT DEPARTMENT AND COMPANY LEVELS

In the Code's *User Manual*, an important chapter is describing the methodologies by which the Code should be implemented in company's current activity.

Development of these methodologies is based on three categories of flows:

The Financial Flow. Formulate the way the company performs and is assessing the financial performance and how the financial result is structured from two different points of view:

- Internal: Company's employees
- External: Shareholders and Creditors

These aspects may have diverging interest areas for the involved parts and there is a necessity to balance and clearly define in the Code's framework the Financial Flow working methodology and structure and than the reporting and assessment methodologies when implementing the Code with reference at this Flow.

The Decision-making Flow. Describes the methodologies of how the decisions in the company are made, the information distribution flow, personnel's access right levels as well as the information flow's management and update.

The Decision – Making Flow must contain in certain situation a contingency plan, well design to match all company's business and non-business related potential events and it must be correlated with the Operational Risk existing rules.

Within this Decision – Making Flow we need to define:

- The Functionality and modalities of implementation of the Company's management decisions at all responsibility levels.
- The Methodologies for assessing, interpreting, monitoring and adjustment - readjustment based on the interpretation of the Code's Scoring Assessment results.

Here we have to take into account, as well as throughout the job classification and allocation categories, on the following directions:

- Responsibilities at department's and personnel's level
- Information Access Rights
- Tasks at department's and personnel's level
- Decision categories that have to be taken at the department and individual level

The Analytical Flow. Describe the department's (directly or indirectly profit generator) working methodologies, the processing of information that have to be disseminated in the decision making process where appropriate.

Thus we have two categories of methodologies featuring this type of Flow:

- Operational - specific for the corporate departments where the primary (raw) information is processed in Analysis Reports (Investment, Sales, Risk, Purchasing etc.) and on which the company's management decisions are made. These methodologies can be evaluated independently and directly quantify the company's financial performance.
- Procedural - specific for the corporate departments where information is indirectly producing performance (called support or "back-up" informational flow) and to quantify company's performance is rather in terms of quality than quantity.

7. CORPORATE EVALUATION BASED ON PERFORMANCE SCORING

I. The implementation of Corporate Governance Code

Evaluation of implementation of the Code and compliance procedures can be found in the *Evaluation Report* of the implementation of Corporate Governance Code

The aim of this report is to make more efficient and easy to control and adjust the Company's continued growth, impacting directly the increasing of financial performance and company's added value, reflected in stock valuation and on the true shareholders satisfaction.

The real valuation of the company is always in accordance with the provisions adopted by the Code. The better the Code is detailed and implemented the higher, company's valuation becomes.

These provisions have to specify in detail:

- Activities, departments and processes that have to be evaluated
- Conditions and principles on which this assessment will be made
- Methodologies and standards that are used in the evaluation process
- Representation and interpretation of results
- Measures to be taken based on the results, well specified and clearly assigning the responsibilities to classes and categories, accordingly to the above specifications.

Classes in terms of the evaluations perspective are converging to the following main issues:

- The company (the Code's Issuer) - through the cyclical process of self-assessment and periodic adjustment
- External entities with experience in auditing the implementation of Corporate Governance Code - in order to establish the adopted compliance procedures and processes and issuing certificates under the Corporate Governance Code framework.
- Shareholders - by making them available a standardized and agreed set of tools and information necessary and relevant to assess the quality of the dialogue and performance achieved by the company's Management.

The evaluation of the Code Implementation is issued in a special report reflecting the results obtained, comparing between the *implemented* Code and the standard provisions *adopted* of the Code, this reflecting:

- The Quantitative degree of the achieved targets
- From the Qualitative point of view:
 - The procedures, processes, and methodologies of the Code to be exactly implemented by the Company, Board and entire personnel
 - Compliance with the allocated time period allocated to fulfil the proposed task and procedures, exactly and in terms of the required performance
 - Reporting (the fulfilment degree of monitoring) the implementation of the Code in the daily activities by linking the associated operational risk to specific procedures.

8. PERFORMANCE EVALUATION OF THE IMPLEMENTED CORPORATE GOVERNANCE CODE

Tracking the results of the Company has to be correlated closely with the correctness of the Code Implementation.

The Code Implementation monitoring is based on a periodic assessment using relevant performance indicators, which are spread over several complexity and category levels.

The evaluation categories adopted several performance indicators, each class being assigned specific departmental or organisational indicators for general use where they track the quantitative or qualitative performance

For activities and disciplines with complex hierarchical structures we build synthetic indicators featuring all-important aspects of the scoring based assessment on that specific area.

Due to the complexity and content of the performance indicators, the following categories of indicators have to be adopted and implemented:

- Human Resources - Personal Skills Development
- Economic and Financial
- Corporate Governance Implementation
- Management Performance

These categories of performance indicators cover the entire range needed to track and monitor the performance created at the personnel level, organization, management and the company's relationship with all shareholders and creditors.

9. ORGANIZATION-WIDE PERFORMANCE ASSESSMENT ON SCORING BASED INDICATORS

The Company's Performance evaluation is based on a system that provides management information analysis tools necessary to substantiate decisions.

This system contain a data acquisition module, the analysis based on statistical and comparative algorithms, primary forms of reporting and interpretation and is called as a whole a Decision - Making Support System (DSS)

10. DECISION - MAKING SUPPORT SYSTEMS (DSS) SPECIALIZED FOR FINANCIAL INSTITUTIONS

A DSS support and assist the company's Management in planning and organizing a company's current activities in a harsh business environment when conditions can change rapidly and unpredictably.

A DSS is a higher and more complex procedure, tactic, strategic and analytic oriented tool, used to dealing with unpredictability in this case is taking measures to avoid, transform or minimize risks that may occur.

A DSS in its essence have two different components::

A. The Information System;

The Information System of a DSS must contain specific information and procedures (business model) that characterize and describe the information flow of the company (also called knowledge based system - KBS).

The KBS is used in identifying and resolving problems that may arise in the business cycle (investment, sales, purchasing etc.).

In KBS we can also find all specified corporate objectives together with all performance (KPI) and Trend (KTI) indicators that are tracking these objectives.

Performance indicators are always synthesized and specified strictly based on the company's profile and they are of two categories: quantitative (directly quantification) and qualitative (indirectly quantification).

The difference between quantitative and qualitative performance indicators is that qualitative indicators tendency is to induce subjective interpretations of the existing classic methods and algorithms for processing and conversion.

Correctly calibrated and correlated with quantitative indicators, the qualitative indicators will give us a wider and clearer image of the company's activity easy to understand, interpret, monitor and adjust.

Opposite to qualitative performance indicators, are the quantitative performance indicators that are more accurate in representing the results at the organization, department and personnel level but can be used only in conjunction to the personnel or departments generating directly the company's financial performance.

Although, a support activity of a department is not necessary describing a task having as performance reference a quantitative output.

Any activity regardless of its nature has limited time in finding the optimal solution correctly adapted to the current situation and features of the business environment.

At the end we do conclude that the time is a highly valued and strong impact variable, indispensable in establishing qualitative performance indicators and it can generate scoring, based on references (benchmarking) easy to interpret, that can underlie the management's decision.

Trend indicators (KTI) help drawing and dynamically adjusting the targeted objectives, monitored by the KPIs and in practice is calculated by simple formulas obtained from the statistical evolution of the Key Performance Indicators (KPI).

KTI are used in the implementation to achieve business goals in close correlation to company's business environment and they are equally used as indicators to monitor the Company's business, to establish market trends, the qualitative development of the business environment and so on.

B. The Organizational System

The Organisational System has the role of implementing in practice the information achieved by the Information System.

The most optimal solution of an DSS applicable to most companies is a sort of DSS called *Cooperative* and is composed by one or more active DSS allowing to the decision maker to adjust, modify, reformulate, etc. the decision before validating it.

The Validation Process is a process of refining and completing the adjustment decision.

Enhanced decision is taken when the loop reformulation - adjustment is considered closed.

The implementation of a *DSS Corporate* (specific for media, financial – banking etc., is widely used in the multinational companies as a sub-set) is using a mixture of these types of DSSs.

- Data Processing oriented - uses historical data series, real-time data, external data

- Reports and Documents oriented - used frequently in the management of documents and certifications based on processes
- Knowledge based - used in complex business environments where is required solutions or suggestions clearly explained to the existing problems (large infrastructure or utilities projects, dams, hydro power plants and more)

11. MANAGEMENT PERFORMANCE BASED ON ASSESSMENT SCORING INDICATORS

Management Performance Indicators known also as Positive Performance Indicators show the cumulated capacities and skills of the management team to reach the proposed goals.

There are companies using Management Performance Indicators of dually structure, both quantitative and qualitative.

The concept of a concrete implementation of the Scoring Based assessment of the managerial performance is mostly using the quantitative (financial) indicators.

The Management performance indicators of a qualitative nature are the outcome of the implementation assessment of the Corporate Governance Code and it is evaluated accordingly.

12. ASSESSMENT APPLICATION USING SCORING BASED MANAGEMENT PERFORMANCE INDICATORS FOR AN INVESTMENT FUND

The description of a management performance assessment system application using scoring methods is aiming to cover the following aspects:

- References used in this method of evaluation of performance indicators consist in building Management Benchmarks based on financial / accounting data or on the portfolio of all companies representing the financial – banking industry the company belongs to, taking into account the restrictions and limitations mentioned further
- To preserve the symmetry and homogeneity of the data used in the construction of these references, when building benchmarks are selected only companies that have at least 80% the degree of similarity of their business activity compared to the analysed company's activity
- Reported results will be compared in a table where the results are listed alongside management performance indicators calculated for the company in one side and the average indicators of the Financial - Banking industry established as reference on the other side. Performance analysis report contains charts, comparative industry representations and once the creation of historical data series archives is achieved, it would be possible to represent the historical evolution and the dynamics of managerial performance relative to a chosen period.
- The weighted averages used in setting Managerial Performance Indicators are equal in the first approximation and will be adjusted and calibrated once the system is actively used and fed with real time data.

- Generally it is very difficult to identify one aspect of a changing situations in the business environment in a single indicator because of that, using synthetic indicators composed of several simple indicators each of the indicators used with its limitations and specific restrictions, may benefit more the assessment process. In this perspective a synthetic complex indicator is based on several simple indicators (which may in turn have a higher complexity degree). The synthetic indicator will use a hierarchical subordinate and the weighting average of the subsequently indicators. The synthetic indicator will be analysed only in intervals the restrictions or limitations are not enabled.
- Formula of complex synthetic indicator is always the object of continuous improvement through the calibration process and is obtained from historical data series accumulated either in back testing or when a historical data archive is established and real time information is gathered by the system.
- A simple indicator can be only used “as it is” if its share in a synthetic indicator is large enough to influences the outcome or the reading of the performance quantified in this way. In this case, this indicator is used to confirm a trend, a situation, conjuncture etc. and this index is used to witness a reference not to be compared against the existing benchmark.
- The concrete situations such as for example the case when emphasizing the return on assets owned for a long time or when the NAV figures are influenced by the market conjuncture. There are also other extreme representations featuring the capital market and highlighted / integrated in indicators showing "under what conditions was achieved the performance and with what resources (quantitative and qualitative approach)"

13. INDIVIDUAL PERFORMANCE ASSESSMENT BASED ON BESPOKEN SCORE CARDS

The Performance Evaluation of the personnel is an issue that is easier to be accomplished if the job description is done accurate using all necessary details and following attributions based on competence acquired as:

- Specialized studies / undergraduate, master, doctorate, etc.
- Specialized courses organized by the company
- Interactive seminars and remote learning courses

The individual evaluation of personnel is using the following methods:

- Automatic based scoring (strictly quantitative) analysis performed on quantitative data, on the obtained results. Here we are dealing with quantitative measurements and assessments of the task duration and complexity and with these types of evaluations:
 - Current load: how efficient and fast the personnel solve tasks they are responsible for
 - The competency the personnel manage to solve tasks in terms of complexity of the task / duties. Here there is a scoring based indicator that is assessing the degree level of task complexity.

- Based on the bespoke scoring card (purely qualitative) made by the leader of the team, department, company, etc.
- On the basis of periodic testing / quiz having as bibliography both specialized knowledge and those relating to the Corporate Governance Code, the existing legislation, etc.

The three results obtained above shall be weighted in the final results and the assessment interpretations, as being able to improve both the training of personnel and the results that they might obtain in current activity.

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