

THE CONCEPT OF CORPORATE GOVERNANCE AND ITS ROLE IN FINANCIAL REPORTING

CZU: 657.6:334.784(478)

DOI: <https://doi.org/10.53486/mfsne2024.12>

Lica ERHAN

PhD, Associate Professor

Academy of Economic Studies of Moldova, Moldova

ORCID: 0000-0001-5204-6367

E-mail: lica.erhan@ase.md

Valentina PALADI

PhD, Associate Professor

Moldova State University, Moldova

ORCID: 0000-0003-0371-4183

E-mail: valentina.paladi@usm.md

Eduard VIERU

Academy of Economic Studies of Moldova, Moldova

ORCID: 0009-0007-8729-1953

E-mail: edwardvieru@mail.ru

Abstract: *Corporate governance represents a complex set of relationships, regulated at the legislative level and built among all persons interested in the corporation. The concept of corporate governance is the overall management of the entity by implementing an effective control system, thereby ensuring that the business is run in the interest of investors and stakeholders.*

The aim of this paper is to examine different models of corporate governance applied in local practice and how this governance is reflected in financial reporting. The requirements regarding the presentation of information related to corporate governance in the management report, as a component of the annual financial reporting, are stipulated in the Law of Accounting and Financial Reporting. In particular, in the management report drawn up and presented annually by all public interest entities, should be included information about the corporate governance code applied by the entity, with reference to the source of the publication; the degree of compliance of the entity with the provisions of the corporate governance code, and if it deviates - the explanation regarding the parts of the code that it does not apply and the reasons for not applying; the entity's internal control and risk management systems, in relation to the financial reporting process, etc.

The results of this paper highlight the way the information related to corporate governance is disclosed in the management report drawn up and presented by the public interest entities. The information presented in the chapter dedicated to corporate governance, as well as in the other sections of the management report, facilitates the users of the financial statements with additional information helping them to assess correctly the activity of the public interest entity and to adopt optimal decisions.

Keywords: *corporate governance, internal control, management report.*

JEL Classification: *G00; G30.*

INTRODUCTION

Corporate governance is a key tool in the management of the entity with the help of which it is possible to ensure the sustainable growth of the entity, to protect the interests of all interested parties, in order to ensure a transparent business environment. The main purpose of corporate governance is to maintain a balance between the interests of shareholders, the entity's management and other stakeholders.

In the Republic of Moldova, the concept of Corporate Governance has been widely used since 2007, with the entry into force of the first Corporate Governance Code, approved by Decision no.

28/6 from 01.06.2007 of the National Securities Commission (currently, the National Financial Market Commission), the provisions of which were intended only for joint-stock companies. Later, by Decision no. 67/10 from 24.12.2015 of the National Commission of the Financial Market, a new Corporate Governance Code was approved, and by Decision no. 820 from 27.10.2023 of the Government of the Republic of Moldova was also approved the Model Code of Corporate Governance of State Enterprises/Municipal Enterprises and Joint Stock Companies/Limited Companies with Full Capital/Majority Public Capital. In accordance with the provisions of these legal documents, each domestic public interest entity, at the end of the management year, is obliged to report the results of corporate governance.

Examining the concept of corporate governance and the way of presenting information related to corporate governance in financial reporting is the purpose of this research.

The methodological basis used in the research is the legal and regulatory framework related to corporate governance and the results of the investigations of domestic and international specialists in the field of corporate governance. In order to carry out the given research, the following methods were used: the analysis of the legal framework and the specialized literature in the field of corporate governance, the synthesis of the information presented in the financial reporting, the deductive and inductive method for the presentation of financial and non-financial information in the financial reporting, as well as the authors' own reflections.

RESULTS AND DISCUSSIONS

In international practice, two models of corporate governance are used: Anglo-American and European. In the opinion of the economist Pilova F.I. „the Anglo-American model is based on the adoption of a strict division between ownership and management. The intervention of the state in the affairs of the entities is very limited. Investment activities for financial institutions are prohibited. The European model, on the contrary, limits the protection of the rights of the owners, placing the interests of the state above the interests of the owners. In such models, banks, lenders, community employees, and unions are involved in corporate affairs”.

Given the fact that the development of the Corporate Governance Code was based on international practice in the field of corporate governance, the principles of corporate governance developed by the Organization for Economic Cooperation and Development (OECD), we can deduce that the European model is applied in domestic practice.

One of the provisions stipulated in the Corporate Governance Code relates to the need to disclose information related to the way corporate governance is organized and its transparency by public interest entities. Section 104 of this Code lists the information related to corporate governance that must be disclosed and placed on the web page of public interest entities. In particular, paragraph 2 of point 104 of this Code stipulates that information related to corporate governance should also be disclosed in the "management report on compliance with corporate governance recommendations and the provisions of the law".

The management report, according to art. 23, paragraph 1 of the Accounting and Financial Reporting Law no. 287/2017, is a document that is prepared and presented annually by all medium-sized entities, large entities and entities of public interest, together with the financial statements. The paragraph (8), art. 23 of this law stipulates that „in the management report of the entity of public interest, a separate chapter dedicated to corporate governance should be included”, containing information on:

1. *The corporate governance code applied by the entity, with reference to the publication source* - in this section the information regarding the development, updating and application within the entity of a corporate governance code, as well as its publication source, must be disclosed.
2. *The degree of compliance of the entity with the provisions of the corporate governance code, and in case it deviates* - the explanation of the parts of the code that it does not apply and the reasons for

non-application - the development, updating and approval of the Corporate Governance Code still does not guarantee an efficient management of the entity. It is essential that the provisions stipulated in the Code are applied and respected in the daily activity of the entity. Taking into account the aforementioned, in this section of the management report, the degree of compliance of entities with all the provisions stipulated in the Code and/or existing deviations must be described. When disclosing this section, the entity could use the Declaration "Compliance or justification", which is an annex to the Corporate Governance Code approved by CNPF Decision no. 67/10/2015. If any approved action or decision deviates from the provisions set forth in the Code, the entity must provide a detailed justification in written form.

3. The entity's internal control and risk management systems, in relation to the financial reporting process - in this section of the management report, information should be disclosed regarding the existence within the entity of internal control and risk management systems that the entity may face in its economic-financial activity. We would like to mention that the internal control system, through its objectives and procedures, aims to ensure a good use of resources (financial, material, human) and their correlation with the entity's objectives. The purpose of the internal control system is to eliminate/reduce the risks that may affect the achievement of the entity's objectives and to improve the management of the controlled activities.

At the same time, a primary element directly related to the internal control system is related to effective risk management. Risk management continuously assesses the risks to which the entity's activity is or may be exposed. Running risk management processes ensures the identification, analysis and assessment of risks, in order to maintain them at acceptable levels, depending on the entity's risk tolerance and its ability to manage these risks.

4. Significant shares of participation in the social capital, direct or indirect - in this section of the management report, it is necessary to disclose the information on the way the social capital was constituted, specifying the significant shares held directly or indirectly in the social capital of the company. It should be mentioned, that currently, there is no normative act, which would accurately explain the notion of „significant share of direct or indirect participation in the share capital of the joint-stock company” and which would establish some level of this share. However, such rules exist, for example, in the case of insurance companies. The entity of public interest, such as a joint-stock company, could use the provisions stipulated in art. 26 and art. 85 of Law no. 1134 from 04.02.1997 on joint-stock companies, namely that of at least 25% of the company's share capital, as the level of the significant share of participation in the social capital.

5. Holders and beneficial owners of any securities that confer special control rights and the description of those rights - the rights of holders of securities are stipulated in the normative acts in force and in the internal documents of the company: Law no. 1134 from 02.04.1997 on joint-stock companies, Law no. 171 from 11.07.2012 on the capital market, the Corporate Governance Code, the Statute society. But in addition to the basic rights (to be informed, to participate and vote in the General Shareholders' Meeting, to receive dividends, to transfer or dispose of the shares in accordance with the law, to be elected to the management bodies of the company, etc.), the holders of securities may also have special rights.

In accordance with art. 3 of Law no. 308 from 22.12.2017 on the prevention and combating of money laundering and the financing of terrorism, (the same definition is also found in art. 3 of Law no. 202 from 06.10.2017 on the activity of banks) beneficial owner - represents a natural person who ultimately owns or controls a natural or legal person or a beneficiary of an investment company or administrator of the investment company, or person in whose name an activity is carried out or a transaction is carried out and/or who holds, directly or indirectly, the ownership or control over at least 25% of the shares or voting rights of the legal entity or over the assets under fiduciary administration. As a result, in the given section of the management report, it is necessary to disclose the information regarding the existence within the company of the beneficial owners of the securities.

When identifying the beneficial owners of securities, the information presented in Decision No. 147 of the Board of Directors of the National Bank of Moldova from 31.07.2014 "Recommendations regarding the identification of the beneficial owner" can be used. In particular, according to point 20 of Decision no. 147, in order to identify who the actual beneficiaries are, it is necessary to establish:

- based on the data from the registration certificate or the extract from the body authorized to carry out the state registration, all persons who own more than 25% of the company's shares or voting rights;
- the persons with the right to appoint or fire the members of the management bodies of the company;
- persons who have the right to exercise a significant influence on the activity of the company and/or its management bodies.

Also, when identifying the effective beneficiaries of the securities, the manner of their participation in the company's share capital or holding the right to vote must also be taken into account: directly or indirectly. For example, if an entity has four founders, three of whom own 20% of the share capital and one 40%, then the beneficial owner will be the shareholder who owns 40%. But it is possible for the shareholders with a 20% share to enter into an agreement by which they transfer their voting rights to one of them, in this case the effective beneficiary will be both the shareholder who owns 40% and the shareholder who benefited from the transmission of voting rights from the other two shareholders.

6. All restrictions regarding the right to vote, such as limiting the right to vote to holders of a certain share of the share capital or a certain number of votes; the deadlines imposed for the exercise of the right to vote or the systems where, with the cooperation of the entity, the financial rights attached to the securities are separated from their ownership - effective corporate governance must protect and contribute to the exercise of the voting rights of the holders of shares in the company's share capital. Resulting from this, in the given section of the management report, it is necessary to disclose the information regarding the existence within the entity of some restrictions or limitations on the voting rights of the holders of a certain share of the share capital or some deadlines imposed on them for the execution of the right to vote. When drafting this section, it is necessary to take into account the provisions stipulated in Law no. 1134 from 02.04.1997 on joint-stock companies, as well as the company's Statute.

7. The provisions of the legislation regarding the appointment and replacement of the members of the council, of the executive body, as well as regarding the amendment of the entity's statute - in the given section of the management report, the information regarding the election of the members of the company's Council and the termination of his powers, the appointment of the members of the executive body, as well as the way of amending the entity's Statute must be presented. When drafting this section, it is necessary to take into account the provisions stipulated in art. 66-70 of Law no. 1134 from 02.04.1997 on joint-stock companies, Decision no. 67/10 from 24.12.2015 regarding the approval of the Corporate Governance Code and the Company Statute.

8. Competences of the board and the executive body regarding the issuance and redemption of securities - in this section of the management report, the competence of the entity's governing bodies regarding the issuance and redemption of securities must be briefly presented. When preparing this section, it is necessary to take into account the provisions of art. 11-15 and art. 79 of Law no. 1134 from 02.04.1997 on joint-stock companies (the version in force from 29.12.2017 based on the amendments by LP274 of 15.12.17), chapter 2 of Law no. 171 from 11.07.2012 on the capital market and by the Statute of the company.

9. The powers and rights of the management bodies, of the shareholders, of other holders of the entity's securities and the ways of exercising them - in this section of the management report, the powers, rights and basic obligations of the management bodies and the owners of the entity are briefly

presented. When preparing this section of the management report, it is necessary to take into account the provisions stipulated in Law no. 1134/1997, Law no. 171/2012, Law no. 845/1992 and the Corporate Governance Code.

10. The structure, mode of operation and composition of the management bodies and of the entity's committees - when preparing this section of the management report, it is necessary to take into account the provisions stipulated in the company's Statute, in which the structure, mode of operation and composition of the management bodies, established in accordance with the normative acts in force (Law no. 1134/1997, Law no. 171/2012, Law no. 845 of 03.01.1992 on entrepreneurship and enterprises).

CONCLUSION

Corporate governance is a valuable tool in the management of any entity. Through it, it is possible to ensure the sustainable development of the entity and the transparency of its activity, attract financial resources and win the trust of partners, protect the interests of all parties participating in its economic activity and build a positive reputation. Investors and other interested parties cannot make reasoned decisions about investments, loans and other business without knowing the actual situation within the entity. That is why a mandatory requirement stipulated in both the Corporate Governance Code and Law no. 287/2017 consists in the disclosure of financial and non-financial information related to the way corporate governance is implemented and achieved. We believe that the information presented in the chapter dedicated to corporate governance in the management report is intended to facilitate the users of the financial statements in the correct evaluation of the public interest activity in the decision-making process.

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