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Supervisory Instruments of Corporate Governance

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Abstract

A separation between capital ownership and management and control of the managers' work represents a portion of corporate governance that is visible. Fundamental aspects of corporate governance are, by origin, linked to the accounting and auditing, more precisely to the controlling and internal audit. The task of the corporate governance is to ensure better functioning of the company and to protect the interests of owners through efficient internal controls, reliable and timely reporting, planning, systems of financial and non-financial evaluations, the system of providing mutual feedback and via reliable information system. If corporate governance is understood as a set of processes, customs, policies, laws, decisions, institutions and supervisory mechanisms that affect the governance and control of the company, it is crucially important to establish inter-relations among organization supervisory instruments, and to determine the true measure of their impact. The research of the application of corporate governance in our business environment is now primarily of an explorative character, it is based on secondary sources and investigates past experiences. The aim of this paper is also of exploratory nature, i.e. it is an attempt to diagnose the situation in order to understand the nature of the problem of application of corporate governance. The research is primarily focused on the observation and definition of synergy of external and internal control mechanisms. Internal instruments mentioned in this paper are the system of financial management and control, integrated management systems (IMS), the assessment of business risks, internal control system, accounting system, modern information system (ERP), and thus supported fast close of the accounting period (FAST CLOSE), internal audit and controlling. External instruments presented in this paper are government measures, legislation and external audit of financial statements. Refraction of supervisory impact, by using these instruments, must be observed through the activities of the executive management, the Supervisory Board and its committee - the Audit Committee.

Key words: *corporate governance, controlling, internal audit, external audit, management, audit committee, supervisory external and internal instruments.*

1. INTRODUCTION

Corporate governance essentially represents a complex set of processes of separation between capital ownership and management and control over the work of managers who use company assets for achieving the objectives of the company and their personal goals. If corporate governance is understood as a set of processes, customs, policies, laws, decisions, institutions and supervisory mechanisms that affect the management and control of the company, it is important to establish inter- relations among supervisory instruments and determine the true measure of their influence. The topic of corporate governance, in theory, was launched by Adam Smith, in his book "The Wealth of Nations" in 1776, in which the author, at that time already, emphasized that directors (managers) can not be expected to take care of and manage the company with the same vigilence with which the owners of the company capital would do it. [1] If we wanted to restore the historical wheel of economic thought related to the separation between the functions of owners and managers we certainly could not avoid mentioning the ancient writer Xenophon, the eldest and most loyal disciple of Socrates, and his manuscript "Economy", written around 370 BC. [2] A very detailed and comprehensive description of ancient economy, that was "embedded in life", we can find in the work of

Moses I. Finley: "*The Ancient Economy*" [3]. A great contribution to the understanding of corporate and private ownership was provided in 1932 by the authors Adolf Berle and Gardiner Means in their paper "*The Modern Corporation and Private Property*," by which the true development of the theory of corporate governance begins. [4]

According to analyses of ISI Web of knowlage, the contribution to the development of scientific thinking on corporate governance was also given by the authors La Porta, R., Lopez-de-Silanes, F., Shleifer, A. [5] [6] [7] [8] Gillan, Hartzell and Starks [9] studied the interrelations of industries, investment possibilities and corporate governance structures. Based on a sample of 2,300 enterprises and companies, having supervised their work for four years, they concluded that management structures vary according to the industry and the characteristics of the enterprise. The same was proved by Black, Jang and Kim [10] based on the examples of companies from Korea whose corporate governance practices are affected by legal regulation and characteristics of certain industrial activities, company size and business risks of the company. Nelson examines the relationship between the success of the company, the composition of the board of directors and its committees, and changes in corporate governance on a sample of 1721 companies over a fifteen year period. [11] Recently, the authors Doige, Karolyi and Stulz investigated the impact of economic development of the country and of developed financial instruments to corporate governance. [12] Their results suggest an important relationship between these variables and the level and quality of corporate governance.

Chaocharia and Laeven conducted a research of the level of development of the governance structure and its impact upon the company value on a sample of 2,300 companies in 23 countries. [13] The results of their research indicate that market "*stimulates*" the companies that are ready to adopt new, own, governance guidelines, in addition to those provided under the legislation and by the corporate model that has been adopted in the country. Practically, the model of corporate governance found its application after the emergence of a modern corporation. After World War II the capital of many companies was nationalized. In the period from 1950’s to 1970’s the number of financial institutions as institutional investors was increasing. Since the late 1980s/early 1990s to the present day we have witnessed major financial frauds due to, primarily, fradulent financial reporting and a number of stock market scandals generated by dishonest managements together with dishonest auditors. The number of joint stock companies that trade on stock exchanges also increases, i.e. the number of public companies and open joint stock companies. After the development of corporations at the end of the 20th century the term of *corporate governance* has become increasingly used, as well as the *corporate governance models*. It can be said that, in the future, the ways to improve corporate governance practices in order to achieve the objectives of the owners and to achieve the control over the objectives of the owners of capital shall be increasingly used, as a means to reduce the possibility of manipulation of the public.

Through a well-adapted organization model and by applying the rules of corporate governance the interests of shareholders and other stakeholders (the state, banks, funds, regulatory bodies, a wide circle of investors, employees) are being looked after. It is in the interest of any corporation to provide a high level of protection of shareholders’ interests because, in that way, it immediately creates a better image of new investments on the market. A corporation and individual private company lean on private property, while the differences occur in the company management and are reflectd in decision making, use of resources, market-orientation, development strategies and in many other segments. The simplest, however sufficiently eloquent, definition by OECD (Organisation for Economic Cooperation and Development) directs the corporate governace towards control "*it is the system by which corporations lead and control*." Corporate governance structure specifies deployment of rights and responsibilities among different participants in the organization - the board, managers, shareholders and other stakeholders and the general public - and lays down rules and procedures for decision-making. [14] Shleifer and Vishny understand corporate governance as the way in which financial suppliers provide to corporations a return on their investments. [15]

Supervisory instruments of corporate governance and their presence in corporations and in other legal forms of organization of the company form the basis of the paper. Effectiveness and efficiency of corporate governance can be achieved by a variety of instruments that, generally, can be divided into internal and external ones. The most frequently cited external instruments of corporate governance are: the market of corporate control; market of products and services; market of management services and legislation. The most frequently cited internal instruments of corporate governance are: supervision of management by the board of directors and possibly the Supervisory Board; appropriate manager incentive systems; internal audit and control by large institutional investors. This research is primarily directed toward observation and defining of synergies between external and internal control mechanisms. External instruments that are analyzed are: a set of state measures, legislation, external audit of the financial statements, the state audit and the impact of measures of Anti-Corruption Agency. Internal instruments that are in the focus of the research are the system of financial management and control, integrated management systems (IMS), the assessment of business risks, internal control system, accounting system, modern information system (ERP), and thus supported fast closure of the accounting period (FAST CLOSE), internal Auditing and Controlling. Refraction of activities by using these instruments must be observed through the activities of the Supervisory Board and its committee - the Audit Committee.

The research on the application of corporate governance instruments in our business environment is now primarily of explorative character and is based on secondary sources and research of past experiences. The aim of this research is also of exploratory nature, i.e. it represents an attempt to diagnose the situation in order to understand the nature of the problem of application of corporate governance and to continue the research in the right direction. The approach used is the one of collecting secondary data and of research of previous experiences. We used electronic databases, scientific and technical publications (both traditional and digital) that are important for the research. In order to analyze the application of external and internal corporate governance instruments in our country, we made use of available reports of state authorities, regulatory bodies, associations of internal auditors and studies on the implementation of corporate governance in the Republic of Serbia.

2. INTERNALLY ORIENTED INSTRUMENTS OF CORPORATE GOVERNANCE

In this section of the paper we shall try to summarize, systematize and describe the main instruments of internal corporate governance which can significantly contribute to successful corporate governance. In addition to the basic description of the functions of internal control instruments, we shall also briefly outline their basic elements which are necessary for understanding of their contribution to the governance, and for the purpose of analyzng the previous researches on this topic.

One of the terms that has become increasingly cited in our business practice is ‘financial management and control’. It is likely that the general public would not find this term clear enough, and it is very often identified with other internal control instruments, such as internal control, internal audit, governance, and even the system of integrated management. Briefly, we can say that the system of financial management and control is synonymous with good management. There are several definitions of it, but what they have all in common is that according to all of them financial management and control (internal controls) comprises the overall system of financial and other control, including the organizational structure, methods and procedures, not only of the financial system, but also of operational and strategic organization systems. Financial management and control constitute the entire system of internal controls established by the company managers, who are actually responsible for this system. This control, via risk management, to a reasonable extent, provide assurance that in the course of achieving the objectives set by companies (organizations) the assets shall be used properly, ethically, economically, efficiently and effectively. The compliance with laws and other regulations, safeguarding of assets against loss, misuse and damage is expected.

Unlike the system of financial management and control, internal audit is established by the management with the purpose to analyze the effectiveness of established internal controls and to support the company in a correct, economical, efficient and effective manner. Internal control represents integrated activities, plans, opinions, policies, systems, resources and efforts of company employees, who work together in order to provide reasonable assurance that the organization will achieve its mission and objectives. Thus, internal controls are focused on the mission of the organization, and that mission has to be taken into account when assessing the adequacy of specific, practically implemented internal controls. In its essence, the system of financial management and control represents the philosophy of the approach to management. In the Republic of Serbia, the system of financial management and control is a legal requirement for direct and indirect beneficiaries of the budget and public enterprises, and as one of the world's best practices it is recommended for all companies. Based on the recommendations and support of the European Union, the Government of the Republic of Serbia adopted the Strategy for development of public internal financial control in the Republic of Serbia. [16] The new version of the Budget system law, instead of internal controls, introduces the term of financial management and control. This legal solution represents the beginning of the introduction of corporate governance in the public sector, in order to increase its effectiveness. [17]

Certainly one of the oldest instruments of management is accounting information system. The accounting system is certainly one of the components which comprises the system of internal controls of the company. "*According to the International Auditing Standards an accounting system is a series of tasks and records of the company which is used to process business events, as the basis for the maintenance of accounting records. This system identifies, collects, analyzes, calculates, classifies, records, summarizes and reports on business changes and other events.*"[18] The basic principles and postulates of the accounting system in the Republic of Serbia are legally regulated by the Law on Accounting and Law on Auditing, and since 2004 they are also largely in line with International accounting standards and International Financial Reporting Standards.

The subject of the integrated management system (IMS) is not strictly "*economic*" in nature. It is essentially, to a large extent, founded on the process organizational approach. Starting from the concept of financial management and control, IMS can be considered as one of its elements, too. It has largely been implemented in the business practice in the Republic of Serbia. Broader activities in terms of its implementation have already been started in the mid nineties. At first the practice of introducing ISO 9001 was started, which uses a process approach for identifying the areas which need to be managed in order to deliver efficient and effective products or services. There are no such requirements in other standards/specifications, however this approach could be useful for identifying all of the issues that an organization must and should manage, since if there were no effective governance a risk would ocurr to a stakeholder. In the afore mentioned standard the emphasis is mainly put on providing the necessary conditions for the delivery of a high-quality product to consumers, as well as on measuring the customer satisfaction, which is a basic prerequisite for ensuring the continuity of business operations of a company. There is another series of ISO standards, subsequently created, that are not integrated with each other. Therefore, the British Standards Institute (BSI) has developed a methodological instruction for integrating two or more management systems, regardless of whether they already exist independently, or the organization has certified one management system but wants to harmonize its business operations with the requirements of other management systems, and named it Publicly Available Specifications, PAS 99: 2006. The Specification insists upon two elements: 1) a systematic approach to defining all the processes and documents of management system, 2) the treatment of risk. PAS specifies common requirements of management systems and intends on becoming a framework/foundation for the implementation of two or more standardized management system in an integrated manner. Many organizations have already adopted, or are in the process of adoption an official management system, or its specifications such as ISO 9001, ISO 14001, ISO/IEC 27001, ISO 22000, ISO/IEC 20000, and OHSAS 18001. These systems often exist independently. All systems of management have certain elements in common that can be managed in an integrated manner, while the substantial unity of these systems within the framework of overall management system can be identified and used as an advantage. [19] Also, we believe that all other business processes, such as procurement, sales, planning and reporting can be presented in the form of IMS documents, thereby raising the overall quality of methodological arrangement and documenting of all business processes in the company. And we also want to emphasize that, simultaneously, this approach is systematic in terms of defining all the processes and documents of management systems, which are also discussed from the risk point of view.

Nowadays, companies are focused on the introduction of a new software-based business system, which does not necessarily imply only accounting, but represents a comprehensive business package that can be used also by users who do not have sufficient knowledge of bookkeeping. "*ERP concept was defined long time ago and it has basically remained unchanged. It is followed by all current leading solutions. ERP solution is a business package that is based on integration of all business processes and material/financial events into a single entity. As a consequence, there is a complex ERP solution. The division of labor in the company enables people with different skills to work on adjusting and / or use of ERP solutions in accordance with specific business issues*. "[20]. Modern, high-quality integrated information systems will not only provide quality reports to management but also directly contribute to the reputation and the value of the company. Most certainly, just like management, customers, internal and external auditors have more confidence in the reliability of data, considering that modern information systems enable implementation of various types of control, both general and applicational, which reduces the likelihood of errors during data entry and processing. ERP software consists of applications designed for supervision of all business processes in a company. In companies where there are specific programs for accounting, payroll, sales, warehouses, there is a huge problem with integration of these applications, especially when they are on different platforms. Since all processes in a company are interconnected, the software that accompanies these processes should also be integrated. This is actually the real strength of ERP system which represents a set of different modules that are fully integrated. The above-mentioned software products enable the establishment of control over the overall business operation, better access to information, increase in efficiency and productivity, faster response to market demands. In other words, ERP software integrates departments and functions of the company into a single program that is executed in a singledatabase. This is a significant step forward in improving the efficiency because integration accelerates the process of business operation. [21]

Although still rarely applied in our companies, a very important instrument of corporate governance that is supported exclusively by an integrated information system is the process of FAST CLOSE, the flast closing of the accounting month, within just a few days. [22] This process provides fast and accurate information about the results achieved in the previous month. When introducing the FAST CLOSE process it is necessary first to define all business processes which have an impact on the balance sheets of the company, as process owners. The basis of the division and definition of processes is a simple accounting approach, the analysis of business processes that have an impact on the balance sheet of the company and it can be represented in seven basic accounting processes and one controlling process, which are represented in Cross Functional flow diagrams which include defined present deadlines for the completion of the process and document flow. The flow diagrams show schematic descriptions of all key business processes, ranging from: 1) records of production balance, 2) inventory valuation, 3) records of trade receivables and indirect taxes, 4) records of liabilities to suppliers and indirect taxes, 5) records of changes on current accounts, liabilities for loans and earnings 6) records of fixed assets, 7) records of transactions in the general ledger, 8) controlling processes related to the allocation of costs per cost center important for the determination of the cost. This approach ensures fast and accurate information access and allows a precise projection of the expected result, as well as its deviation from the planned values.

Over the past ten years the internal audit function has been increasingly applied in our business practices. According to the definition of the Global Institute of Internal Auditors: "*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to* *evaluating and improving the effectiveness of risk management, control and management processes*." In our country it was originally legally founded in the Law on Accounting and Law on Aduting, and later also in the Budget system law, as well.

The former term of 'planning and analysis' is today replaced by a more contemporary term of '*controlling*'. "*Controlling can be summarized as the process of navigating towards economic objectives, where the management, definition of the position, is performed by scheduling and monitoring of adopted plans, and the controller is a pilot. The role of the controller can be compared with the role of a navigator on the board of a ship. He helps the captain to reach the destination, while overcoming obstacles and by giving directions in terms of which way to go in order to arrive to the finish safely* " [23] It is important to emphasize the joint role of internal audit and controlling, as two key functions in modern corporate governance. "Controlling and Internal Audit are advisory, consulting activities in the organization. By providing recommendations and advice they contribute to achieving of goals at all levels of management and leadership. Internal audit, in addition, by participating in and initiating the introduction of the model of business risk assessment (which may affect the achievement of company goals) adds value to permanence and stability of business operation. First of all, only clearly defined and budgeted objectives, total and analytically precise up to the required level of detail, both on the revenue and on the expenditure sides, provide a basic guideline to the company. On the way to achieving the objective over time, the controller is nowdays able, with the support of modern ERP (Enterprise Resource Planning) systems, to almost daily report of any deviations from targets. [24]

In our country, "*alongside the introduction of the process of risk management, as a part of the process of establishing a system of internal controls, simultaneously gradually and discreetly the process of corporatization of the management of companies is introduced, as well as of direct and indirect budget beneficiaries, in accordance with best international practices in this area* " [25] The most widely used model of establishing a system of internal controls in the world and in the Republic of Serbia is the COSO model. The central point of the COSO model is business risk analysis. Since recently, the risk management has been also prescribed by the ISO 31000: 2009 standard, however it has not been widely applied in Serbia yet. In its essence, it is also based on the model of COSO risk management, as one of the basic models of modern ERM (Enterprise risk management) model.

Considering the above, we can conclude that the central role in the process of corporate governance belongs to the control mechanisms that are centered around risk management. Internal control mechanisms, by using a variety of its control "*tools*", not only that facilitate risk assessment, definition, recognition and measurement, but they also lead to a significant reduction of the inherent risks. Some of the basic tools mentioned in this article that help ERM (Enterprise Risk Management) are: financial management and control, accounting information system, internal audit, controlling integrated management system, ERP, Fast Close. Quantification, in theory and in practice, and measurement of inherent risk are generally recognized, and are the product of probability and financial impact. The problem arises regarding the method of measuring residual risk, which is more difficult to measure. Some authors express the level of residual risk as the level of organization. The level of organization is usually measured by achieved business results or performance indicators. These indicators are very often influenced by other factors as well (market, price, monopoly etc.). Therefore, these factors can not be used to measure the level of organization with certainity. Level of organization can be measured only by observing the organizational elements of corporate governance, i.e. by the efficiency of management reaction to certain disturbances and threats that can affect the achievement of its goals. The efficiency primarily dependens on the level and timeliness of information access. Hence, it follows that information is a crucial element, as well as the knowledge how to use it. These are the elements that can predict the trend of the business processes, or more specifically they can provide an early warning.

3. EXTERNAL INSTRUMENTS OF CORPORATE GOVERNANCE

The process management, from a practical point of view, is performed by successive business decision-making and control over the implementation of decisions. [26] Corporate governance and management are two different activities. Governance is a concept that represents the accountability to preserve and increase capital, it is in the center of ownership. It exists outside the concept of management, it is accountable for the adoption and implementation of the most general decisions. Management is a function of the executive board of directors, of managers who have a framework for making decisions within their competence and set restrictions in decision-making and management of operations. Boards of directors are also facing demands to bear responsibility for management.

Corporate governance involves a manner (method, model) for the boards of directors to adopt a full potential of the responsibility for management, the way to strengthen and achieve autonomy, while not sacrificing the power of management. Corporate governance represents the separation between capital ownership and management and control over the work of managers who use company assets for achieving the objectives of the company and their personal goals. The model of corporate governance due to its very nature must be implemented in all types of enterprises and organizations, regardless of who owns the capital and in what legal form the company is registered.

Also, a singular owner of the company (e.g. of a limited liability company which is also the founder and director of the company), must constantly bear in mind that he only owns thecapital, while the funds are owned by the company and that he must separate personal finances from company finances.[24]

External mechanisms of corporate governance relate primarily to the market for corporate control, which effectively monitors the management of the company. Thus the companies that are not efficient enough, or the ones whose management does not operate efficiently, can be quickly taken-over by more efficient companies. Also, among the most effective mechanisms of corporate control are the market and mobility of managers, which are driving the management towards efficient business operation since there is a possibility of them being replaced.One of the most important mechanisms of corporate governance, typical of the countries that do not have a developed capital market is the concentration of ownership.

A relatively large majority stake in the company will enable efficient supervision of management by the owner, accompanied by minor agency costs. The disadvantage of this mechanism is that it often causes that minority owners are put in a subordinate position in relation to large ones and to expropriation of their rights.

Speaking of the types of corporate governance, the most important division is the division into shareholders and stakeholders types of corporate governance. [27]

The system of shareholders corporate governance assumes that the primary function of corporate governance is to enable maximization of shareholders profit. This classical principle of corporate governance is based on the attitudes of Berle and Means, according to which there is a separation between ownership and management in the company that leads to a conflict of interest. [4]

According to the agency theory, which stems from conflicting views and objectives of management (maximization of their own interests such as the salary level and insufficient engagement), and goals of their principals (maximizing the value of company equity) i.e. of the owner, the main intention of the owner is, by implementing various management mechanisms, to try to effectively supervise the management, with the main objective to make it behave and react in the best interest of the principal-owner.

On the other hand, the shareholders principle of corporate governance is focused on fulfilling of multiple objectives, reconciliation of interests and goals of employees, the state, suppliers, investors, etc. This principle is primarily focused on public- social interest, unlike shareholders approach for which private interests are a priority. [28] Among the most important criteria are the treatment, relative strength and behavior of the owner, in terms of whether the ownership structure is based on a large number of dispersed owners (outsider system) or on blocks of significant owners who actively participate in the supervision and operation of companies (insider system).

The Anglo-Saxon's, or a so-called outsider system of corporate governance is characteristic of UK, USA and Australia. This system is based on a large dispersion of ownership (individual ownership interest usually does not exceed 3%), where the owners do not behave as active participants in the capital markets, but as investors with a long-term vision of the company in which they invest. In these systems there are highly sophisticated corporate instruments, as well as institutional mechanisms of independent members of the Board, external auditors, developed capital markets, managerial labor markets, managerial compensation systems in compliance with the quality of performance, i.e. bonuses, or hostile acquistion of the company, all of which affect the alignment of the interests of management with the interests of the owner, without the need for a major owners' interference in the work of management.

On the other hand, the European, continental or so-called insider system is a type of corporate governance in which the secondary market of shares is rather undeveloped, and where the concentration of ownership is significant (with an average ownership share in the range of 10% -25%), with special emphasis on the possibility of their direct impact on the company's management.

This system is characterized by poorly developed capital markets and the lack of more sophisticated instruments of corporate governance, while the main source of conflict arises between the majority owners and small shareholders, because of a weak institutional protection of minority shareholders. Typically, the framework of a European type of corporate governance includes subgroups that are mainly related to different institutional identities of the majority owner.

Namely, in Germany and Japan, majority owners are mostly from the financial sector and they are at the same time the largest financiers of these companies, while in the Scandinavian countries, as well as in Italy and Spain, family ownership is the most prominent. Considering the development of the capital market, the level of its liquidity, and high level of ownership in the post-privatization period (with the privatization still ongoing) in the Republic of Serbia predominant is the latter model, the model of continental corporate governance. In any form of company organization, in any form of organization of administration or functional division of labor, it is important to bear in mind the authority of the function and accountability of the function holder, as prof. Danilo Vujičić claims in his book. [29]

In countries in transition, also, there are attempts to formally establish the rules that will contribute to more efficient and more effective corporate governance. Under our present day conditions, these efforts have resulted in the adoption of the Corporate Governance Code which defines the rules that are "Referral, explaining, interpreting, helping, and only when supported by a legal basis they become imperative. [30] This, however, does not mean, in any case, that these rules, being of legal nature, are not binding as well. So for any potential deviation from the recommendations it is necessary to provide an explanation, i.e. justifiable reasons for the deviation and also the proposals that represent rules which do not have to be accepted, nor it is required to provide any explanation for departing from them, and which are considered as a desirable practice in the area of corporate governance. In our country a significant amount of legislation has been adopted, such as, the Company Law, Law on Public Enterprises, Law on Budget, Law on the State Audit Institution, as well as bylaws, which provide a modern basis for the introduction and development of a model of corporate governance.

The most important sources of information on the status and success of any company are financial statements which are prepared periodically, usually at the end of the year, and presented to all interested parties.

Since it is the management that is responsible for the preparation of financial statements, and since it, as we have repeatedly emphasized, does not have identical objectives as the capital owners, owners and other users of accounting information when making business decisions can sufficiently rely on the information from the financial statements due to the fact that these are subject to mandatory external audits, assurances, i.e. systematic review of the ledgers and financial statements which is performed by external auditors and experts. The purpose of financial reporting is to provide to the corporate decision-makers in the capital market with useful, relevant and reliable information. Important qualities of financial information are the completeness and transparency.

The role of external auditors that are present in the inter-relation of the company and its environment is essential, as it provides a greater assurance about the accuracy of the information provided by the management [31]. Corporate governance is inextricably linked with the independence of auditors' work. However, a large number of financial scandals which involves internationally well-known corporations, such as Enron, WorldCom, Credit Lyonnais, Vivendi, Parmalat, Adecco, i.e. their managements indicates that the agency problem is extremely severe and that it is necessary to continue to work on finding new, or improve the existing solutions in order to protect stockholders' equity. The current world economic crisis also points to the fact that financial markets, for which it was supposed that they represented the perfect way for assessing the corporate companies and their managements, actually were not the omnipotent mechanism and that the risks of misuse of owners' capital will continue to exist. The quality of work of external auditing and supervisory board is of great importance to a good corporate governance practice. [32] The great importance for the quality of financial reporting is attributed to the function of the audit committee, which in its framework also cooperates with external and internal audits and which can evaluate the control environment of the company in the best way possible.

Abdel-Khaliq proposes that the independence of the audit can be achieved by excluding the authority to recruit and replace auditors from management. [33] In our country, after the establishment of the Chamber of Auditors and the introduction of the institute of state audit, there is a significant external stimulus for the introduction of the system of internal controls, internal audit, and assessment of business risks and therefore of a good practice of company management.

4. DEVELOPMENT OF CONTROL MECHANISMS OF CORPORATE GOVERNANCE IN THE REPUBLIC OF SERBIA

The approach used for evaluation of the development of control mechanisms of corporate governance in the Republic of Serbia is the collection of secondary data. To this end electronic databases, scientific and technical publications, both traditional and digital, relevant for the this area of research have been used. In order to analyze the application of internal and external instruments of corporate governance in our country, available reports of state bodies, regulatory bodies, associations of internal auditors, studies on the application of corporate governance in the Republic of Serbia have been used.

For the purpose of assessing the development of the basic elements and institutional structure of corporate governance (the number and composition of administrative, supervisory and audit committees), the results of a survey conducted as a part of the 2008 research of the status of corporate governance in Serbia in 214 joint stock companies can be used. [34] "Only joint stock companies were selected because they, primarily, are the ones that are dealing with corporate governance issues, based on the separation between ownership and management, but also because they represent a dominant part of the economy of Serbia, not only in terms of turnover, but also in terms of their number. Among the 214 surveyed companies, 91are from the industry sector, 68 from trade, 33 from construction and 22 from finance. In regards to the development of the basic elements of corporate governance, first of all, it has been noted: "In Serbia the status of corporate governance is not commendable and Serbian economy is still lagging behind other, particularly developed countries. There are several reasons for this. First, a considerable number of enterprises have not been privitized yet; including some large state-owned enterprises and some socially owned or mixed companies, which are big loss-makers. Despite normative innovations, their operation is essentially still prevailed by old, socialist, self-management mechanisms, based on the social/state ownership and strong political influence: the director is the most important factor, despite the normative dominance of administrative boards and assemblies, and all important decisions depend on him; political factors outside the company are still very much interfereing with making of strategic decisions, even the appointment of directors; there is still a soft budget constraint, relying on government subsidies, the absence of bankruptcy, etc; transparency of procedures is low, so the breaches of procedures are frequent (often at someone else's expense), however they usually go unpunished; paying salaries to employees usually is the main motive of business operation, as it used to be in the times of self-management. "[34] Furthermore, it has been noted:" Certainly, the shareholders' interests come, or should come, in the first place via respecting the interests of society, in order to increase its value. In addition to the interests of the society, in making important business decisions usually taken into account are the interests of the employees (60%), customers (35%), banks (22%), government (20%) creditors (18%) and suppliers (16%) ". In regards to the institutional structure the following is claimed: "*The Board of Directors is almost a universal body in 96% of cases. Supervisory boards are represented in two thirds of cases, 68%.* "[34] A review of this research, from the aspect of this paper, has been made in order to present the general status of corporate governance in the Republic of Serbia. As for the issue of the development of external and internal control mechanisms, this research has analysed a couple of elements of the issue. If we look at external control mechanisms, we certainly should take into consideration the external audit and the quality of its work, so therefore the findings of the mentioned research are interesting: "A local auditing firm is the auditor of 54% of joint stock companies constituting the sample, an international auditing firm is the auditor in 22% of the companies and an individual auditor in 16% of cases. International auditing firms, predominantly (55%), are engaged by companies from the financial sector.Such a finding certainly does not speak highly of the quality of external audits, if we start from the assumption that more qualified auditing personnel is actually employed in international auditing firms. The lack of transparency of the entire process of corporate governance is specifically indicated by the following fact: "*Almost 59% of companies do not publish their financial statements and business reports (except for the submission of final accounts to the National Bank), 41% of companies do so by submitting these to media, 58% of companies publish these reports on the Internet, while 17% of companies do so by submitting the reports to economic and financial analysts, 13% of companies do so in some other way.* "[34] Further analysis of the function of accounting in Serbia, as the basic internal control mechanism, according to this study states the following:" The quality of accounting statements is an important element of transparency. International Accounting Standards (IAS) are used by 79% of joint stock companies surveyed in their accounting, while 11% of the companies do not use them. Financial reports based on International Financial Reporting Standards (IFRS) are prepared by more than three-quarters of companies in the sample, while only 9% of companies do not do that. These are good indicators. It seems that the accounting in Serbia is well managed. Because the latest auditing report does not include negative assessments in terms of the manner in which accounts are managed in 78% of joint stock companies of the sample, and includes in 9%. "[34]

There are studies with a small number of subjects in the field of internal auditing and the status of financial management and control, which also include research on risk assessment. This experiment was conducted by the IIA in cooperation with UIRS (Association of internal auditors of Serbia), while for the research on the development of certain mechanisms in the public sector that have already been mentioned, for a few years back, there are data obtained by the research of Central harmonization unit. [36] Considering the importance of the process of risk management for the entire process of corporate governance, we shall provide below a systematization of the findings from the aforementioned field. Research of UIRS was conducted in the period from 15 March to 17 May 2010, under the auspices of the Global IIA (Institute of Internal Auditors-Global) as a comprehensive international study of the status of the internal auditor profession in the Republic of Serbia. [35] The research comprised a number of internal auditors from Serbia, 42 auditors from 31 companies, as determined by the number of answers provided to specific questions. Regarding the classification according to the industry: the largest representation of internal auditors is in the banking sector and financial institutions 61.29%, followed by the insurance industry with 13.19%, then the mining industry and the oil industry with 6.45%, and the state and local administration and compulsory social security with 3.23%. Based on the number of respondents interviewed it was concluded that only in 56.52% of the cases a risk assessment has been conducted in order to define the strategic and annual action plans and the scope of the audit. When asked on what basis the action plan of the audit is determined, the following has been identified: in 43.48% it is based on risk assessment methodologies, in 26.09% on the review of the plans from the previous year, in 21.74% it is based on the requirements of management or of the audit committee. In the study conducted by the Ministry of Finance, Central harmonization unit of the Republic of Serbia, published in the annual report for 2011, it is also concluded that the level of development of financial management and control, as well as of internal audit of direct and indirect budget beneficiaries is inadequate, and therefore risk management is also underdeveloped. "Based on the reports received it was determined that the majority public fund beneficiaries have action plans, financial plans, procurement plans and periodic reports. These responses also indicate that public fund beneficiaries are in the initial stage of acceptance of the methodology of risk management and that the existing control systems are established primarily for the purpose of ensuring the legality of business operations. Control systems are not sufficiently focused on overcoming risks that may affect the realization of other general goals of the organization. The responses that the public fund beneficiaries provided in the general section of the questionnaire, stating that they have established internal controls in business processes by taking into account the most significant risks, are not in accordance with the responses provided in the self-assessment part, which is related to the risk management. These reports, among other things, conclude the following: out of the 150 public fund beneficiaries who received the questionnaire on financial management and control (FMC), responses were provided by 97 public fund beneficiaries, out of which there were 85 filled forms and 12 notifications that they have not established the system yet; 1) only 39 or 26% of the total number of the interviewed organizations responded that they have established a system of FMC; 2) only 47 organizations have developed a business process map, i.e. 31%, and 14 organizations listed the most important business processes not stipulated in writing, i.e. 9.3%, and no organization has established the complete model of assessment and risk management. Out of the 150 beneficiaries of public funds that were sent questionnaires on the status of internal audit (IA), 96 provided responses to the question of the establishment of the internal audit function. Only in 41 or 27.3% of the total number of the interviewed organizations there is an established internal audit function, which represents an increase of 28% as compared to 2009, when the internal audit was organized in only 32 organizations. The mentioned survey also indicates a very low level of development of the function of financial management and control, of the accompanying internal audit, and consequently derived categories of risk management in the public sector.

In their records on the audit of financial statements and compliance of the business operation, the State Audit Institution in the chapter on internal control and audit, in most cases, concludes that the direct and indirect beneficiaries of the budget, as well as the public enterprises (national and local self-government) have not established a system of financial management and control, have not introduced a system of assessment and management of business risks and have not established an internal audit function. [37] "*Thus, despite the legal obligation to establish the risk management process via the process of introduction of financial management and internal audit, in our country this is still undeveloped, which can be claimed based on the above mentioned studies and reports from the aforementioned field. The establishment of the internal audit function and of the related obligation of risk management are more developed in larger companies, especially in those in which the ownership transformation occurred and in which foreign capital was introduced, in banks and financial institutions, insurance sector and the oil industry*. "[25]

5. INSTEAD OF CONCLUSION

Implementing the principles of corporate governance in transition economies is a long-lasting process that depends primarily on the strength of institutions, quality of implementation of legislation, inflow of the practice of different countries through foreign direct investments, rate of development of the secondary market and the introduction of corporate governance. The assumption, based on the experiences of countries in transition, that the change of the direct ownership of the companies, the completion of the privatization process, as well as attracting foreign capital will lead to direct implementation of high quality and strong institutional framework and practice of corporate governance proved to be inaccurate. Despite significant efforts to create legislation that allows uninterrupted operation of companies and of their governing bodies, the fact is that in terms of the still underdeveloped capital market and its low liquidity, underdevelopment of financial instruments and institutions, the companies in Serbia tend to be borrowing from the financial sector. By relying on the financial sector and long-term financing the private shareholders sector is based on closed types of companies, such as limited liability companies; there is no separation between management and ownership. The companies in the Republic of Serbia use majority ownership as the most influential instrument of corporate governance.

The perspective is that the development of financial markets, by more efficient judicial system and generally with the growth of the companies, which cannot rely only on external short-term and long-term financing, will lead to "*dilution*" of ownership and greater reliance on internal corporate mechanisms. The enterprises - companies in Serbia, posess the instruments, the tools for corporate governance which have proved to be a good practice in the world. We think that a broader study than the one aforementioned, on the degree of implementation of risk management as a common element of many of these internal control mechanisms, could provide a clearer picture of the use of internal control mechanisms.

At the same time we should consider possible ways of measuring the effectiveness of the established control mechanisms and calculation of residual risk. Whereas the one of the key indicators should be the number of days required for the preparation of monthly financial statements of the company from the last day of the month for which the report is prepared, as an indicator of the speed of information flow. So far, corporate governance has been mainly engaged only in its framework and imitation of management (especially in state-owned companies). Domicile Corporate Governance Code stipulates that the supervisory board - board of directors must have a majority of non-executive members, which in our conditions is causing aproblem, above all, with the professionalism and competence of non-executive members of the board, due to the fact that party cadres who have very little experience, or whose professional qualifications are insufficient, are being elected into the boards. It is not rare that the members of the supervisory board - board of directors are persons who have just started their professional career, or are engaged in professional activities which have nothing to do with the operations of the company in whose administrative or supervisory board they are appointed.

However, the main driver of real changes will be the recognition of the stakeholders that good corporate governance is an essential part of good governance and efficient management - the key elements of sustainable organizational success. Shareholders, as well as boards should review the effectiveness of their systems of corporate governance. This means that based on good corporate governance, a proper balance in the powers of management, i.e. the owner is established (and potentially of other stakeholders, such as employees), clear and transparent flow of information and reporting, accountability which is created at the level of the different layers of the organization, internal controls and risk management practices, internal audit function as an independent business audit, as well as the high ethical standards that have become the norm at the level of the company as a whole. In regards to crisis management, good corporate governance enables the supervisory board - board of directors and senior management to cope with the arising problems and prevent them from transforming into a crisis. However, if a problem occurs anyway, inspite of a good corporate governance (for example, due to external factors), the roles and responsibilities of the different decision-makers are clear, corporate bodies and officers know what to do, there is an open discussion about unusual situations and the solution is reached quickly. Further integration of our country into the European and global economy will not only increase the competition and thus make more modern systems (including corporate governance) necessary, but it will also transpose the best practices and experiences of corporate governance. In the coming years, foreign and domestic investors and creditors will require greater transparency through independent directors and built-in instruments of corporate governance in the corpus of the organization. The implementation of the corporate governance framework requires a certain amount of time. The regulations that closely follow the international standards are currently in force in most countries and in our country as well. However, the legal system is often cumbersome, poorly implemented, or it is even thwarted by political interference and corruption. This often makes the work of the board more difficult, especially for companies that strive for transparency and for stakeholders who strive towards responsibility. Development and proper implementation of the necessary institutional infrastructure and "*soft*" rules of conduct for addressing issues such as corporate social responsibility, employee relations, as well as the behavior of the different directors in the boards of directors will take many years. In addition, it should be borne in mind that in developed countries the concept of corporate governance with much more active boards of directors gained in importance only in the mid-nineties, and then rapidly expanded after the "dot-com" crisis (crisis of Internet companies) and the consequences of corporate crises such as the "Enron" in early 2000. In all situations, whether it was a company or a country, the key question is whether corporate governance adds value to the organization, whether there are political interests at the level of the state and the interests of capital owners to implement the best practice into their respective reality.

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Nadzorni instrumenti korporativnog upravljanja

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Apstrakt

Razdvajanje vlasništva nad kapitalom od rukovođenja i kontrola nad radom menadžera predstavlja vidljivi deo korporativnog upravljanja. Suštinski aspekti korporativnog upravljanja su izvorno povezani sa računovodstvom i revizijom, preciznije sa kontrolingom i internom revizijom. Korporativno upravljanje ima zadatak da obezbedi bolje funkcionisanje preduzeća i zaštitu interesa vlasnika kroz efikasne sisteme interne kontrole, verodostojnog i pravovremenog izveštavanja, planiranja, sisteme finansijskog i nefinansijskog vrednovanja, kroz sisteme međusobnih povratnih veza i verodostojne informacione siteme. Cilj ovog rada je takođe eksplorativnog karaktera, odnosno predstavlja pokušaj dijagnostifikovanje stanja, radi upoznavanja sa prirodom problema primene instrumenata korporativnog upravljanja. Istraživanje je pre svega usmereno u pravcu posmatranja i definisanja sinergije eksternih i internih kontrolnih mehanizama. Interni instrumenti spomenuti u ovom radu jesu sistem finansijskog upravljanja i kontrole, integrisani sistemi menadžmenta (IMS), procena poslovnih rizika, sistem interne kontrole, računovodstveni sistem, savremeni informacioni sistem (ERP), i time podržano brzo zatvaranje računovodstvenog perioda (FAST CLOSE), interna revizija i kontroling. Eksterni instrumenti koji se obuhvataju ovim radom jesu državne mere, zakonska regulativa i eksterna revizija finansijskih izveštaja. Prelamanje nadzornog uticaja, pomoću ovih instrumenata, obavezno se moraju posmatrati kroz aktivnosti izvršnog menadžmenta, nadzornog odbora i njegove komisije – revizorskog odbora.

Ključne reči: *korporativno upravljanje, kontroling, interna revizija, eksterna revizija, menadžment, revizorski odbor, nadzorni eksterni i interni instrumenti.*