The corporate governance mechanism and its role in the reduction of financial and administrative corruption

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Abstract- The emerging phenomenon of administrative and financial corruption is considered as one of the most serious and pressing issues facing a host of countries, including in particular developing countries. In fact, this has led to a recession in the process of economic development and growth, especially with the resulting destruction of the economy and the financial and administrative potential of the state and equally of institutions.

The continuous financial crunches and scandals which affected the largest companies in the world, especially those listed in the capital markets have proved the failure of traditional methods to avert the causes of those mishaps. This in fact prompted the concerned authorities at the national and international levels to conduct in-depth studies to determine the main reasons leading to these financial crises and complications, which were significantly associated with the accounting and financial aspects.

Governance is considered as the most important mechanism in addressing the phenomenon of financial and administrative corruption, and is carried out in the form of a variety of mechanisms, notably transparency and disclosure of financial and non-financial information that are prepared in accordance with accounting standards, as well as strengthening the role of the internal and external auditing, especially with respect to the independence of these two functions1.

Key Words- corporate governance; corruption; administrative corruption; financial corruption.

I. Introduction

The problem of corruption has received the attention of many researchers and practitioners interested in this phenomenon, with views, agreeing on the need to develop and establish an institutional framework designed to address the problem thought-out and specific action plans. These plans are aimed at fighting corruption in all its forms and manifestations and in all areas of life to accelerate the process of economic development2. The issue of financial and administrative corruption is not confined in terms of its impacts to the negative aspects felt in a certain sector of society, but it also extends to all members and sectors of society.

It certainly has a direct impact on the country’s overall performance in the market and impedes economic development, as well as causing a disruption in the structural foundation of the larger community. In addition, such ill practices can turn individuals against their own values by embracing behaviours that are considered alien and unwelcome in any society where those values and principles are usually well-established. One should not also underestimate its impact on the political life with the disruption to the rules of the game in politics and the emergence of political systems and entities geared towards manipulating capital and using fraudulent means, such as bribery.

It can be noticed that after the various financial crises that occurred in many companies in East Asia, Latin America and Russia in the nineties of the last century, and which were triggered by financial corruption, mismanagement and lack of auditing, experience and skills, in addition to lack of transparency, these crises and failures have led many shareholders to suffer heavy

financial losses, prompting many investors to look for companies that adhere to the concept of corporate governance. Corporate governance has grown in importance as a result of the tendency of many countries around the world to switch to capitalist economic systems which largely depend on private companies. As a result, there has been increased attention to the concept of corporate governance, which has become one of the key mainstays underpinning economic forms.

The research aims to highlight the concept of financial and administrative corruption by reviewing its causes and economic, political and social effects, as well as addressing definitional issues of the concept of corporate governance and the principles of the Organization for Economic Cooperation and Development (OECD) and the various advantages and different mechanisms granted by the governance in order to address the phenomenon of financial and administrative corruption.

A number of studies and research data have indicated that the collapse of many economic firms was caused by the manifestations and effects of financial and administrative corruption, which resulted in the loss of rights for the existing investors and lack of confidence for new investors in these companies. As such, there has been so much interest in the application of the concept of corporate governance as the best solution and the safest and fastest method to address these negative aspects that have surfaced with the collapse of a sizable number of economic institutions. It is appropriate then to put the research problem into context using the following main question: How can the adoption of corporate governance mechanisms address the issue of financial and administrative corruption?

The current research is divided into four main parts, which are as follows:

1. A general overview of corporate governance.
2. Financial and administrative corruption.
3. The role of governance mechanisms in decreasing the financial and administrative corruption.
4. Research findings.

1. General overview of corporate governance

1.1 Theoretical framework for corporate governance:

Even though the term has only been adopted recently- it can be traced back to quite some time. The theoretical and historical premise of corporate governance stems from the Agency Theory, which was introduced by two Americans scholars who noticed that there should be a separation between the ownership of the company’s capital and the process of control and supervision within the managed companies. This separation has its effects on the company’s performance level. Following Berle and Means, 1932, some other efforts were noted, especially the role of two American economists who won the Nobel Prize for the economy, who focused on the concept of corporate governance and highlighted its importance in reducing or minimising the problems that might arise from the separation of ownership and management, as shown in the agency theory. In 1976, they offered a definition for this famous theory (Agency Theory) as a relationship under which the main party (capital owner) resorts to the services of another person “worker” in order to substitute or deputise him/her in the performance of some of the tasks. As such, these ‘tasks’ require that he/she acts on the owner’s behalf in power. This was followed by a host of academic and practical studies which highlighted the importance of adhering to the principles of corporate governance and its impact on increased investor trust in the members of corporate boards; and as such, the ability of states to attract new investors, whether they are local or foreign, and the consequent development of the local economies of these states. It can be said that corporate governance came as a reaction or

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5 Report of committee on the financial aspects of corporate governance (1992)


response to the continuous calls from shareholders to minimise management negative practices and to impose a supervisory system to protect the common interests of all stakeholders and to maintain the lifecycle of the company in the meantime.

1.2 Definition of corporate governance:

The term governance is a multifaceted concept with various connotations. First, one should focus on its linguistic and terminological dimensions.

1.2.1 Linguistic dimension:

The word ‘governance’ dates back to an old Greek term (good governor). It refers to a ship master’s ability and skills to guide his vessel in the middle of sea waves, hurricanes, and storms. Also, it relates to his noble values and ethics, as well as honesty in preserving the lives and property of ship passengers.

The term corporate governance in English comes from the verb ‘governs’, which means rule or dominate; however, in Arabic, there has not been an agreed synonym for the term. Similarly, the collocation of the term with ‘corporate’ has more than one meaning. In this context, meaning, there appears to be more than fifteen meanings in the Arabic language for the term. It is also difficult to find a common definition among all economists and legal experts, as well as analysts and accountants for the concept of corporate governance, which can be due to the overlaps in terms of the several regulatory, economic, financial and social issues characterising institutions.

1.2.2 Terminological dimension:

A wide range of definitions has been offered for this term. It is an integrated system of financial and non-financial control, through which an enterprise is managed and controlled. It can also refer to a number of methods that can ensure that investors achieve a reasonable profit for their investments. The Organisation for Economic Cooperation and Development (OECD) defined corporate governance as the sum of relationships linking those managing the company’s affairs to the board of directors and shareholders, as well as other shareholders. According to the Cadbury Report, “corporate governance is a system whereby companies are managed and monitored.” On the other hand, the Centre International Private Enterprise (CIPE) defines CG as the framework in which institutions exercise its presence, and describes the concept in terms of the relationship among the staff, board members, shareholders, stakeholders and state policy-makers, and how they interact with each other in the process of controlling the company’s operations. Given the previous definitions, it can be said that corporate governance is a system intended to develop good applications and practices for those in charge of the company’s management and administration in order to maintain the rights of shareholders, bondholders and employees of the company campaign, as well as other stakeholders. This can be carried out by investigating the application of the contractual relations that bind them using the appropriate financial and accounting tools, according to the required standards of disclosure and transparency.

1.3 The importance and objectives of corporate governance:

As a result of administrative and financial failures occurring in many global companies, interest in the application of the concept of corporate governance has increased by the simple fact that the demise of those institutions was mainly by the lack of a good style of governance.

1.3.1 Importance of the application of corporate governance:

The significance of corporate governance lies in the several advantages it offers, including:

- Fighting against corruption within companies by not allowing it to exist or continue. It is thus a process of completely eliminating corruption and ensuring it has no place inside these companies.

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• Ensuring that all employees directly or indirectly involved with the company, including the Board of Directors and executive directors to the lowest ranked in the company integral, impartial, and upright.
• Creating a sound and healthy environment free from intentional or unintentional misconduct and preventing the persistence of this behaviour and any other shortcomings.
• Dealing with all sorts of misconduct and not allowing any repeat, especially those whose presence constitutes a threat to the shareholders’ interests or whose persistence may make reaching the desired outcomes difficult for the company and thus in need for an urgent reform.
• Reducing the margin for error as much as possible through the use of a protective system that prevents these errors and thus avails companies the financial burdens caused by such errors\textsuperscript{17}.

1.3.2 Goals of corporate governance:
According to the standards and determinants of corporate governance, the aim is to achieve a number of goals, which can be summed up in the following:

- Improving the project’s ability to achieve its objectives by improving the mental image and the positive impression people have about it.
  - Enhancing decision-making in companies by increasing managers’ sense of responsibility and the possibility of holding them accountable through the General Assembly.
  - Improving the credibility of the data and information and ensuring it is easy to understand across the globe.
  - Incorporating considerations of environmental and ethical issues in the decision-making process.
  - Improving the degree of transparency, clarity, disclosure and dissemination of data and information to increase the ability of projects to be competitive and attract investment capital and other funds.
  - Increasing the administration’s ability to motivate employees, as well maximising the turnover rates of employment and the stability of workers in the workplace\textsuperscript{18}.

Corporate governance also allows for the creation of confidence among dealers in the era of financial scandals and recessions and enables business investors to gain access to a wide range of tools that give them control over their assets which are distributed over several investment takings and ensure they maximise their benefits. This is best illustrated in the following figure:

![Figure (1): The objectives of corporate governance \textsuperscript{19}](image-url)

<table>
<thead>
<tr>
<th>The goals of Corporate governance</th>
<th>Enhancing the mental image about the companies.</th>
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<td>Improving decision-making.</td>
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<td>Enhancing corporate credibility.</td>
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<td></td>
<td>Introducing ethical considerations.</td>
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<td></td>
<td>Improving the degree of clarity and transparency.</td>
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1.3.2.1 Dimensions of corporate governance and the main implementing parties:
According to the aforementioned, it is evident that there are different dimensions of corporate governance with which many actors continuously interact consistent with their respective powers and responsibilities.

Corporate governance dimensions:
Corporate governance has a variety of dimensions that can be summed up in the following elements:

- **The supervisory dimension:** This dimension is related to strengthening and activating the supervisory role of the Board of Directors to assume the tasks of executive management and stakeholders.
- **The regulatory and control dimension:** It undertakes to strengthen and activate the control both of the internal and external level in the company. At the internal level, the support and initiation of control are focused on the activation of internal control and risk management systems, while at the external level, it deals with laws, regulations and rules

\textsuperscript{19} Mohsen Ahmad Al-Khudairi (Corporate governance, the Arab Nile Group), 2005, P21

for registration on the stock market and availing the opportunity for the shareholders and stakeholders to contribute into the monitoring process, as well as expanding the scope of responsibilities of the external auditor and strengthening his/her independence.

- **The ethical dimension:** This is related to creating and improving the auditing environment, including any ethical rules, integrity, trustworthiness, and dissemination of the culture of corporate governance at the executive level and the business environment in general.

- **Communication and maintaining the balance:** This refers to the design and organisation of relations between the company represented by the Board of Directors and executive management on the one hand, and external parties, be it those who have interests in the company or the monitoring, supervision and regulatory authorities on the other.

- **The strategic dimension:** It looks into the formulation of business strategies and encouragement of strategic thinking, as well as building a futuristic vision on the basis of a careful consideration and sufficient information on its past and current performance. It is also related to the study of the external environment factors and the assessment of the different impacts on the basis of sufficient information on the internal environment factors and how they influence one another.

- **Accountability:** This component identifies the disclosure of the various activities and performance levels of the company for the purpose of shareholders and others who are entitled legally to hold the company accountable.

- **Disclosure and transparency:** These two dimensions are related not only to the necessary information required to rationalise the decisions of all parties interested in the company, but also expands the concept to include disclosure in the public domain in terms of the general reports indicating adherence to the principles of governance in accordance with the recommendations of the New York Stock Exchange.

### Parties in charge of implementing corporate governance:

There are four main parties that can affect and be affected by the appropriate application of the rules of governance and may to a large degree determine the extent of success or failure in the application of these rules, including:

- **Shareholders:** This category includes those who provide capital through their ownership of shares and in return for making profits, and also through the maximisation of the enterprise value in the long term. They have the right to choose the members of the Board of Directors who they deem most suitable to protect their interests.

- **Board of Directors:** The Board of Directors formulates the general policies of the organisation and selects the executives who will be entrusted with the day to day management of the activities of the business, as well as supervising their performance. It is also responsible for the structuring of the various committees that play an important role in activating the role of governance in terms of stabilising the business performance, including the Audit Committee and the Risk Management Committee.

- **Management:** Management is responsible for the day-to-day management of the institution and for providing reports on the actual performance to the Board. It is also in charge of maximising profits, in addition to its responsibility towards the disclosure and transparency of the information it publishes.

- **Stakeholders:** Stakeholders are a group of people who have an interest within the organisation, such as creditors, suppliers, workers, and other members of staff, even though these interests can sometimes be conflicting. For example, for creditors, the ability of the company to repay its debt is important, but for the staff, continuity is more important.

### Principles of Corporate Governance:

The principles of corporate governance issued by the Organization for Economic Cooperation and Development (OECD), 2004 are based on national initiatives and experiences of the member states in the organisation and on previous work carried out within the organisation, as well as the contributions of a number of non-member states. One should also mention the contributions of the

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World Bank, the International Monetary Fund, the business sector, and investors, in addition to other interested parties in the issue of corporate governance.

Principles issued by the Organization for Economic Cooperation and Development (OECD):

Ever since these principles were issued in May 1999, they have been the fundamental tenets for the application of corporate governance. There have also been several important amendments that were passed after numerous intensive public consultations and the revised wording of the principles were finally approved by the OECD’s member states on April 22, 2004. The six principles are outlined as follows.

- The introduction of adequate corporate governance frameworks to ensure efficiency, transparency and effectiveness of markets, and to clearly define the allocation of responsibilities among the various supervisory and executive bodies.
- Safeguarding the rights of all shareholders, including:
  - The transfer of stock ownership.
  - The right to choose the Board of Directors.
  - Access to returns of profits and audits of financial statements.
  - The right to participate in the meetings of the General Assembly of the company.
  - The right to vote.
- Equality between all shareholders. In other words, treating shareholders whether internal or external (locals or foreigners) the same in terms of voting in the General Assembly as well as their right to be informed about all relevant transactions.
- Finding a legal mechanism that allows the shareholders participate in the effective supervision of the company and to have access to the required information. These shareholders include bank managers, employees, bondholders and customers.
- The application of disclosure and transparency in a timely manner for all the company’s business activities, including the financial situation, performance, and ownership. The disclosure process should be carried out in a fair way among all shareholders.
- Determining the duties and functions of the Board of Directors and how they are selected, as well as their respective roles in overseeing the company’s management.

Basel Committee Standards on Global Banking Supervision:

In 1999, the Basel Committee issued instructions and guidance on corporate governance in the banking and financial institutions. The following are the most important of these instructions:

- The establishment of ethical agreements among institutions to achieve and implement appropriate codes of conduct between these institutions.
- Developing a strategy for the company that allows for the contribution of all parties and individual participants.
- Identifying and assigning responsibilities and decision-making positions among the members of the Board of Directors.
- Identifying a system that includes internal and external auditing tasks and an independent management.
- Providing a framework or a mechanism determining the type and form of cooperation between the Board of Directors and auditors.
- Identifying a form of surveillance for risk areas, such as major shareholders and senior management.
- Ensuring a just and equal process as well as an appropriate criteria when distributing financial and administrative incentives, whether the process involves managers or employees, and whether these incentives include monetary or promotional or administrative benefits.
- Ensuring the provision and flow of the appropriate information.

Standards of the International Finance Corporation:

In 2003, the International Finance Corporation of the World Bank issued a number of financial and administrative rules and principles whose role would be to support governance within companies, including notably:

Developing practices that should be good and acceptable.

- Identifying new ways to ensure good governance.
- Key contributions to the development and improvement of good governance at the local level.
- Good leadership.

Financial and administrative corruption:

There has been increased interest in the issue of corruption since the second half of the eighties due to its negative effects on economic, social and political development. As such, a number of studies tackled the issue of corruption by presenting the various forms of corruption and its manifestations and analysing this phenomenon in a serious endeavour to unveil its causes and thus reduce its proliferation.

It should be pointed out that the issue of corruption has been a source of concern for many analysts and academics at all the national and global levels. The United Nations Convention against Corruption introduced its preamble with a strong statement indicating the seriousness of this phenomenon and the negative impacts that can have on humanity as a whole. In fact, all states signing up to this convention expressed their concerns about the problems and risks corruption poses to the stability and security of societies all over the world, which can undermine the institution of democracy and its values, as well as other ethical values, such as justice. Other issues resulting from corruption include the fact that it jeopardises sustainable development and puts the authority of law at risk, in addition to its links to other forms of crime, in particular organised crime and financial crime, including money laundering. These states are also concerned about cases of corruption which involve vast amounts of assets, and may at times account for a significant proportion of their resources, which can threaten the political stability and sustainable development in those countries. There is a solid belief that corruption is no longer a domestic affair, but it is a global phenomenon affecting all societies and economies and making international cooperation for its prevention and control a crucial procedure.

1.4 Identifying the notion of corruption:

We will try to define the concept of corruption from a linguistic and terminological point of view.

1.4.1 The linguistic meaning:

Corruption in language dictionaries refers to changing or debasing something by making errors or alterations. It is simply the opposite of rectifying and improving the state of something. The word can even denote nullity and decay, along with many other different meanings that can vary according to its context reference. Among the uses of corruption is famine or drought as in the verse where Allah (SWT) says: “Has appeared the corruption in the land and the sea for what have earned (the) hands (of) people, so that He may let them taste a part (of) that which they have done so that they may return” (Chapter 30, Verse 41). It can also refer to tyranny and arrogance as in Chapter 28 Verse 83- to those who do not desire exaltedness upon the earth or corruption.

It can be inferred from the above how the Quran forbids corruption and makes it one of the most abhorred acts. Thus, it can be said that corruption literally means damage, destruction and disruption, leaving no room for moderation, and is the opposite of reforming and changing for the better.

1.4.2 The terminological meaning:

A number of definitions have been given to the term corruption, with the most important being that of the Encyclopaedia of Social Sciences, according to which corruption is the misuse of public power to make personal profit. This definition has actually included the bribery of local or state officials, or/and political bribes, with the exception of the private sector. It has also been associated with the breach of the law and public order, and failure to comply with regulations with the purpose to achieve political, economic and social interests for an individual or a particular group. As for the definition of the IMF, corruption is defined as the overstretched hands that aim to make profits for one person or any other group of individuals. According to the

International Transparency Organisation, the term carries an eloquent and comprehensive meaning as it defines it in terms of the “the abuse of public power for private gain”\(^{31}\).

Therefore, the latter definition provides a number of key elements in that:

- The definition applies to the three governmental sectors; namely, the private, and public.
- It refers to the abuse on the part of the state and the individuals, which ranges between deception and illegal and criminal activities.
- It covers both financial and non-financial gains.
- It refers to the importance of the governance system in terms of controlling and regulating the exercise of power.

It sheds light on the inefficient costs associated with corruption and the transfer of funds to be used where they are not initially intended. With regards to the definition of corruption in the eyes of the Arab legislator, Law 06 issued on 20 February 2006 for all Arab members contained the same terms of the International Convention for the Fight against Corruption known as “Prevention and Combating of Corruption Act”\(^{32}\). In its definition of corruption, Article 2 of this Act in paragraph (a) was restricted all the crimes set forth in Part 4 of the Act. By reference to Part 4 of the Prevention and Control of Corruption Act, it is noted that the Arab legislator has accounted for the criminalisation of a number of acts that amounted to 20 crimes\(^{33}\).

It is clear from all these different definitions that the phenomenon of corruption is based on the transfer of public interests of the group to the private interest, whereby resources and economic return are allocated and distributed according to personal interest and not according to the common good.

1.4.3 The reasons for the emergence of financial and administrative corruption and its dimensions:

There are many different reasons that led to the emergence of financial and administrative corruption and had in the process a number of political, economic, and social implications, which are listed as follows:

1.4.3.1 The reasons for the emergence of financial and administrative corruption:

The negative phenomena affecting communities cannot be addressed unless their root causes are diagnosed. The World Bank has actually identified a variety of reasons for the emergence of financial and administrative corruption, which can be highlighted as follows:

- Marginalisation of the role of regulatory institutions, which may also be suffering from corruption.
- The existence of bureaucratic practices in state institutions.
- There is a state of vacuum in the political scene caused by the struggle for control of state institutions.
- The weakened role of civil society institutions and their marginalisation.
- The befitting social and political environment has largely contributed to the emergence of corruption\(^{34}\).

1.4.3.2 The dimensions of financial and administrative corruption:

In addition to the above, one can identify three dimensions for financial and administrative corruption, which can be summed up as follows:

The political dimension:

The reasons for the administrative and financial corruption can be ascribed to the weak political will in dealing with corruption. In addition, there appears to be no initiatives to combat this plaguing phenomenon. Even when decisions are made for reform, they remain absurd and unfulfilled, which renders the role of reformers meaningless, even though they might have serious and sincere intentions to reform\(^{35}\).


Without the political will, the fight against corruption will be only limited to the theoretical endeavours, while the role of reformers will be confined to appeals and wishes to no avail. The absence of political will lead to the absence of the state’s political, legal and constitutional institutions. As a result, self-motivation to fight corruption will not be as robust as should be under the threat of murder, kidnapping, career marginalisation and elimination, as in the case of Libya now. In addition, the control mechanisms in the state will largely be disrupted, especially that governments do not hold their institutions or administrations accountable even though they already know about their corrupted practices. In addition, the judiciary body treats state officials as untouchable despite the rumours and facts surrounding their financial dealings. As for the control bodies, they are either disabled due to the severity of the corruptive behaviour that exceeds their capacity, or the symptoms of corruption have actually begun to hit their own structures hard36.

The economic dimension:
This involves unemployment, low salaries and wages, income inequality, and a significant drop in living standards in general, as well as the absence of economic efficiency in the state and the large number of shady business deals or transactions resulting from the brokerage operations that are largely characterised by financial corruption.

The social dimension:
This is largely manifest when everything acquires a price tag, including a worker carrying out a certain professional duty, or a transaction with the state departments, or the conduct of business affairs. It seems that corruption has become part and parcel of the culture and society in which these practices have been rife to the point that communities have developed their own culture of corruption. In fact, when corruption hits hard at the heart of a society, it is difficult to treat. Similarly, corruption breeds more corruption and corrupt individuals will increasingly look at their activities as common practice, which leads one to assume that it needs a major force to be able to deal with it37.

1.4.4 Aspects of financial and administrative corruption and its effects:
Corruption can have very serious and devastating impacts on the economy and society. It can amount to a form of embezzlement of the national wealth, through which public funds can leak illegally into the pockets of corrupt perpetrators, often finding their way out of the country, rather than being utilised locally for the public interest. Corruption also degrades political legitimacy and strips away the rights of ordinary citizens, as well as marginalise them in political life38. In addition, it contributes to spin and bias in the economic and political decision-making process, which can result in the wrong choices and decisions being taken and causes services to miss their legitimate target among those desperately in need and be directed towards certain interest groups. When corruption is rampant and in total control in a given society, the political foundations are completely shaken and the rule of law is seriously jeopardised, which gives persistent perpetrators the opportunity to search for other means to gain money illegally. One can safely say that the spread of corruption in all areas of life makes any country suffering from this plague go into a vicious circle that cannot be easily controlled. Financial and administrative corruption have multiple manifestations and serious effects as will be outlined in the following section.

1.4.4.1 Aspects of financial and administrative corruption:
Financial and administrative corruption have a number of economic, social, administrative and moral features, which can be summed in the following:

- The political features: Corruption manifests itself in the prolongation of corrupt authoritarian rule and the loss of democracy, as well as the lack of participation in the political process, not to mention the corruption of the rulers, the government control over the economy and rampant nepotism practices.


• The financial features: corruption can be manifest in the financial deviations and non-compliance with the rules and financial provisions governing the administrative and financial operations of the country’s institutions, as well as the violation of the financial regulators’ instructions. The major aspects of financial corruption include bribery, embezzlement, tax evasion and nepotism in terms of job appointments and career promotions.39

• The administrative features: From an administrative point of view, this relates to institutional, functional or organisational deviations revealed in the conduct of public officials while carrying out their tasks of the workplace. Administrative corruption manifests itself in the sluggishness of the staff members and lack of respect for the time factor at work by passing their time engaged in idle activities that have no relevance to their job. In addition, it does refer to lack of responsibility and disclosure of confidential job information.

• The moral features: Ethically, corruption are largely associated with moral and behavioural deviations, as revealed in the conduct of state employees. In this respect, some individuals may exploit their position for personal interests at the expense of the public interest. In addition, there is the practice of favouritism, according to which efficiency and merit considerations are not taken into account when hiring employees.

1.4.4.2 Effects of financial and administrative corruption:

The financial and administrative corruption enables certain individuals, especially in public companies, to acquire monetary gains and other privileges at the expense of others in society. These financial and administrative gains can be seen in the immediate increases that affect the cost of transactions, which is in turn reflected in the price paid by consumers or other beneficiaries for the goods and services provided by the individual(s) paying the bribe.

The increases in the cost may not in any way represent the most serious in comparison to other aspects; however, once it turns into a desire to receive personal gains, it soon becomes the only important element in the business transaction, while setting aside the cost and quality elements, and the date and method of the delivery, as well as all other legal considerations upon the approval of the contract. The only outcome then is the selection of unsuitable suppliers or unfit contractors, in addition to the purchase of faulty or inadequate goods.40 Accordingly, priority is given to non-essential projects at the expense of the important ones, with no apparent reason except for enabling decision makers and government officials to make quick profit and easy money through bribery and other corrupt means.

In general, one can identify some of the economic effects of corruption, which can be summed in the following points:

• Corruption contributes to the deteriorating state of the public investment and the low quality of public infrastructure, due to the increasing bribery practices that limit or abuse the resources allocated for investment or even fail to make the projects cost-effective.
• Corruption has a direct impact on the size and quality of foreign investment, including the potential transfer of skills and technology resources availed through these investments. A wide array of studies has shown that corruption undermines these investment flows and can even bring them to a halt; and as a result, it contributes to the reduction in tax returns and the decline in human development indicators, particularly with respect to indicators of education and health.
• Corruption is usually associated with deteriorating conditions in terms of income and wealth distribution, with people in power abusing their social and political positions, which allows them to achieve the highest share of the economic benefits provided by the system, in addition to the continuous accumulation of assets. This process allows them to widen the gap between them as the elite and the rest of society.
• Job cuts can be one of the long terms impacts of corruption, as the spread of this phenomenon places obstacles in the face of expanding private enterprise and increases the business costs. As such, this undermines the investment chances of these businesses and forces to go into the non-recognised sector, and ultimately reduces employment opportunities in the private sector as they are more likely going to fail to reach the satisfactory growth levels.

It is worth pointing out that small firms and business are the most affected in such process. The corporate governance mechanism and its role in the reduction of financial and administrative corruption:

It should be pointed out that financial and administrative corruption is one of the most serious problems faced by private firms and public organisations, in particular. As already mentioned, these types of corruption, which include profits and privileges that are obtained through illegal means, have potential ramifications, with companies bearing the additional costs reflected in the prices of goods produced or services provided. Such practices weaken the companies’ ability to compete and survive and lead to loss of capital. Instead of being drivers of the economy and a leading factor for growth, these companies become an additional burden on the national economy. Corporate governance can thus play an important role in addressing the problems faced by these companies, notably the problem of financial and administrative corruption. This can be done through a range of mechanisms that have been classified by Impavido. Into internal and external governance mechanisms, as briefly addressed below:

1.5 Internal mechanisms of corporate governance

Internal governance mechanisms focus on the activities and practices of the company, as well as on the necessary course of action to achieve the company’s goals. Internal corporate governance mechanisms can be classified into the following:

1.5.1 The role of the Board of Directors

As stated by Activists, researchers and practitioners in the field of corporate governance see the Board of Directors as the most appropriate tool to control management behaviour, since this body is responsible for protecting the capital invested in the company from being misused by managers and administrators by means of its legal powers in the appointment, dismissal and reward of senior management.

In addition, an effective board of directors is actively involved in the formulation of the company’s strategy, and provides the appropriate incentives for management, while observing their behaviour and performance, which allows the board to maximise the value of the company.

In order to achieve this, however, the board should be in a strong position to serve the interests of the company. At the same time, the social corporate responsibilities should be taken into account, while assuming the necessary authority to exercise and act upon the internal laws away from any political and bureaucratic interference in the company’s affairs. One should also point out the board’s role in terms of the selection of senior management, as well as the ongoing supervision of the company’s performance and disclosure of its annual and other reports. Figure 2 illustrates the basic components of the Board of Directors (BD).

43 Ibid
In order to enable the Board of Directors to carry out their guidance and supervision duties, a number of committees have to be created from amongst its non-executive members. The main advantage of these committees is that it does not replace the Board of Directors, but has to submit a detailed report to the board. It can be thus said that the board has the final say and assumes full responsibility.

### 1.5.2 Audit Committee

Recently, the Audit Committee has attracted great interest by the international scientific bodies, and local and specialist researchers, especially after the financial failures and turmoil befalling international companies. This huge attention is due mainly to the role that could be played by the Audit Committee as one of the corporate governance tools in building trust and increasing transparency in the financial information disclosed by companies, which can be achieved through their role in the preparation of financial reporting and supervision of the internal audit function within companies, as well as supporting the external audit bodies and reinforcing their independence, not to mention the emphasis on adhering to the principles of corporate governance.

The concept of an auditing committee emerged after the financial collapse of some outsized companies, as already mentioned. In the United States, the Sarbanes Oxley Act was issued in 2002 to force all companies to create an Audit Committee because of its important role in the prevention of such financial collapses in the future. This can be seen mainly in the process of preparing financial statements, as well as increasing the internal and external auditors’ autonomy. Therefore, the Act allowed for a new body to oversee and regulate the auditors and facilitated the passage of regulations regarding corporate responsibility.

In the United Kingdom, a number of recommendations were issued regarding the launch of this committee, especially the Smith Report, in which included many guidelines on the role and responsibilities of the Audit Committee and how the disclosure of these responsibilities would be set out in the annual reports of companies.

It should be noted that there are many other countries, such as Canada, France, Germany, Malaysia, and Singapore, where the concept of this committee had existed for such a long time. This concept has evolved after the endorsement of a number of recommendations and proposals to resolve the problems faced by this committee in practice and to enable these committees to become an important tool of corporate governance.

Regarding the creation of audit committees in the state-owned enterprises, it has been shown that the call for such creation appeared for the first time in the recommendations of the King Report in South Africa in 1994 which was followed by many other recommendations to form the committee in many countries. Before addressing the importance of these committees and their duties, one should first look at the purpose behind their creation. Due to the multiplicity of definitions in the literature on audit committees, the researcher will only provide two definitions; the first by one of the professional bodies and the second offered by one of the researchers.

The Auditing Committee is defined by the Canadian Trust for Certified Accountants (CTCA) as “a committee made up of the company’s board members who have focused their attention on the review of the annual financial statements before they are delivered to the Board of Directors”. The committee’s activities can be summed up in the nomination of the external auditor and discussing the scope and results of the investigation with him/her, as well as reviewing the company’s internal control system and ensuring its effectiveness, not to mention the role of the committee in ensuring the application of the corporate governance rules in the auditing process.

According to, an auditing committee refers to “a body created by the Board of Directors, which is made up of a number of non-executive members. The committee meetings should be attended by internal and external auditors, if and when necessary, and roles and/or powers are delegated in accordance with the provisions established by the Board of Directors. In addition, periodic reports have to be submitted to Chairman of the Board.

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According to the previous definitions, it is clear that the auditing committee is defined in the light of its members and responsibilities, in addition to being created by the Board of Directors. Its membership is also confined to the non-executive members of the Board of Directors who have both independence and expertise in the field of accounting and auditing. The committee’s tasks and responsibilities relate to financial reporting and review of internal and external audit processes, as well as reviewing the adherence to the rules of corporate governance as set out by the company management51.

1.5.2.1 The functions and tasks of the Audit Committee:

The Audit Committee is responsible for a number of tasks and functions that can be outlined as follows:

- Reviewing the financial statements before submission to the Board of Directors.
- Recommending the appointment, remuneration and exemption of the external auditor.
- Discussing the scope and nature of the priorities in the audits and entering agreements for their application.
- Meeting with the external auditors to address any reservations or problems that may arise during the audit process.
- Holding discussions with external and internal auditors to evaluate the effectiveness of the internal control system in the company and the risk management.
- Overseeing the internal audit function and reviewing their reports and findings, as well as making recommendations to management to take action.
- Carrying out any tasks assigned by the Board of Directors that are relevant to the work of the audit and control committee.

1.5.3 Remuneration Committee

Most of the studies on corporate governance and the recommendations emanating from interested parties have advised that the Board of Directors should create remuneration committees from the non-executive members. In the area of state-owned enterprises, the guidelines of the Organisation for Economic Cooperation and Development (OECD)52, came to emphasise the need for the members of the Board of Directors to create reasonable remuneration so as to ensure the promotion of the interests of the company in the long run by attracting and retaining professionals of the highest calibre.

1.5.3.1 The Remuneration Committee functions and tasks

The functions and tasks of the Remuneration Committee are largely focused on deciding the salaries, allowances and benefits for senior management53. Outlined such responsibilities in the following:

- Deciding perks, bonuses and other benefits for senior management, as well as conducting regular reviews and providing recommendations to the Board of Directors for ratification.
- Developing policies for the senior management bonus programs and reviewing these policies on a regular basis.
- Taking steps to modify the senior management remuneration programs as there might payments that are not reasonably linked to the performance of a member of the senior management.
- Developing policies for the benefits offered by an administration that can be reviewed on a regular basis54.

1.5.4 Appointment Committees

Members of the Board of Directors and staff should be appointed from among the best candidates whose skills and experience should be consistent with the skills and expertise specified by the company. Thus, to ensure transparency in the appointment of the board members and the rest of the staff, a wide range of duties and tasks has been set for the committee.

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53 Mintz, H. (2015), Manager, Sabby Management, Local Address: Upper Saddle River, New Jersey, United States,
1.5.4.1 The functions and duties of the Appointment Committee

- In collaboration with the Board of Directors and with the approval of the appropriate minister, the appointment committee should take charge of the skills required of a member of the Board of Directors and other sought after members of staff.
- The committee has to establish transparent mechanisms for an appointment to ensure access to the best qualified candidates.
- The committee, along with the rest of the members of the Board of Directors, should constantly evaluate the skills required for the company.
- The committee should announce the required, post and invite qualified candidates to apply for appointment.

It should be pointed out that the commission has to be objective by comparing the qualifications and skills of the candidate with the company’s set of specifications and job description.

1.5.5 Internal Auditing

The internal auditing function plays an important role in corporate governance as it enhances the process by increasing the ability of citizens to hold the company accountable. By carrying certain activities, the internal auditors can increase credibility and ensure justice, as well as improve the staff members’ behaviour and reduce the risk of administrative and financial corruption. In this context, in that all of the internal audit state-owned enterprises and reduce the risk of administrative and financial corruption. In this context, CSRC, Administrative Measures for Information Disclosure of Listed Companies (February, 2007).


57 Impavido G. and Hess D. (2003) (as n.30 above)

The internal auditing function has to be independent, well-organised, and has its own legislation. For this purpose, and as confirmed by Cohen, J. R., & Holder-Webb, L. (2005). Rethinking the influence of agency theory in the accounting academy. Issues in Accounting Education Retrieved November 10, 2005 the role strengthening the independence of this function can be done when the reports are submitted to the Audit Committee directly and not to the administration. In addition, the effectiveness of the internal audit committee can be increased when its members are able to obtain important and private information about the organisation, as well as strengthening the internal control system and the quality of accounting policies used.

1.6 The external mechanisms of corporate governance:

The external mechanisms of corporate governance are manifested in the variety of controls practiced by the external stakeholders of the company, and the pressures exerted by concerned international organisations. This is one of the major forces placing a tremendous pressure for the application of corporate governance regulations, including the following mechanisms:

1.6.1 The competitive market (products/services) and administrative work market:

The competitive market (products/services) is one of the key mechanisms of corporate governance. Such significance has been emphasised by Cohen, J. R., & Holder-Webb, L. (2005). Rethinking the influence of agency theory in the accounting academy. Issues in Accounting Education Retrieved November 10, 2005 who stated that if the administration has not carried out its duties properly or eligible, the company will fail to compete with other companies operating in the same industry, and could thus be exposed to bankruptcy.

Therefore, the competitive market of products or services refines the management behaviour, especially if there is an active market for the administrative work of the senior management. This indicates that leading the company to a state of bankruptcy can have a negative effect on the future of the manager and board members. It should be pointed out that the appropriate criteria for selection stipulate that holding positions of responsibility should not be assigned to members of the board of directors or executives that have already led their companies into bankruptcy or liquidation.
1.6.2 Mergers and acquisitions:

One of the traditional tools used in restructuring in the corporate sector in many countries all over the world is undoubtedly represented in mergers and acquisitions. Highlighted sections of the literature and other evidence that supports the point of view that acquisition is an important mechanism of corporate governance (in the United States for example).

Without it, one cannot effectively control the behaviour of the administration, as it is often the case that the services of low-performing departments will be dispensed with when the process of acquisition or merger takes place.

In state-owned enterprises, the OECD indicated that the Chinese government, for example, has benefited from this mechanism as soon as they started giving these companies a good deal of autonomy in decision-making, including acquisition and merger decisions. However, the state still needs to rest assured that its rights as a stakeholder are not abused due to such important decisions taken by the departments. In addition, the acquisition has no impact on the state-owned companies because it can happen in private equity companies, which is not the subject of the study. As for mergers, this has been stipulated by the law of public companies; however, as far as the researcher is concerned, this mechanism has not been activated.

1.6.3 External Auditing

The external auditor plays an important role in helping to improve the quality of financial statements. In order to achieve this, he/she should discuss the quality of those statements with the Audit Committee, and not just whether they are acceptable. With the increasing emphasis on the role of boards of directors, and in particular the Audit Committee, in the selection of the external auditor, saw that independent and active committees may call for an audit of a high quality, thus the selection of qualified and specialist auditors in the industry or field in which the company operates.

External auditing is considered the cornerstone of good governance in state-owned enterprises where external auditors can help these companies achieve accountability and integrity, as well as improve their financial operations and provide a climate of confidence among stakeholders and other sharing citizens. The Institute of Internal Auditors (IIA) in the United States of America confirmed that the role of the external audit enhances the responsibilities of corporate governance in terms of supervision, insight and wisdom. Supervision is focused to checking whether the state-owned enterprises are carrying out what they are supposed to do and are being useful in the detection and prevention of financial and administrative corruption. Insight helps decision makers by providing them with an independent assessment of programs, policies, processes and outcomes.

Finally, wisdom is a significant factor as it determines how to deal with the tough tasks and challenges faced by the company. To accomplish each of these roles, external auditors have to adopt financial and performance auditing, monitoring and advisory services. In fact, some professional organisations and regulatory bodies have stressed the need for external auditors to help decision makers by providing them with an independent assessment of programs, policies, processes and outcomes.

1.6.4 Legislation and laws

Often, these mechanisms may affect the interactions that take place between the actors directly involved in the governance process. Some laws have in fact affected the key actors in the governance process, not in connection with their job and their role in this process, but on how they interact with each other. For example, with the issuance the Sarbanes-Oxley Act on it became undisputedly the largest federal law, in connection with corporate governance since the issuance of the initial laws in the 1930s on stocks. There have been new requirements since then with regards to public shareholding companies, including increasing the number of independent board members; reinforcing supervision of the Audit Committee over the financial reporting process; requiring the Chief Executive Officer (CEO) and the Chief Finance Officer (CFO) to bear witness on the accuracy of the financial reports and the internal control system; developing effective communication between the external auditor and the Auditing Committee; and determining who in the company can ratify the transactions that have a priority in the company and which may be harmful to the interests of the owners and other corporate stakeholders. Other requirements included the task of appointing and

61 Parker, A (2003), 'Tories to Lobby against Higgs Plan', Financial Times, 2 April
exempting the external auditor, as well as approval of non-audit services that can be provided by companies for its customers in the auditing committee.

1.6.5 Other external governance mechanisms

In addition to the aforementioned, there are other external governance mechanisms that can complement and positively affect the effectiveness of corporate governance in the process of protecting the interests of stakeholders in the company. Stated that these mechanisms involve–but not restricted to– regulators, financial analysts and some international organisations. For example, the International Transparency Organisation exerts tremendous pressure on governments and states in order to combat financial and administrative corruption.

Similarly, the World Trade Organisation applies countless pressures in order to improve the financial and accounting systems, while in the banking sector, the Basel Committee is pushing hard in order to exercise governance in banking institutions. As such, due to the diversity of governance mechanisms and the multiplicity of their sources, the implementation requires a comprehensive framework that takes into consideration all stakeholders in the companies, whether private or state-owned, as they all play an important role in the governance process through their continuous interaction within the framework of governance. One can refer to the interaction between the auditing committee and the external auditor, the internal auditor, the board of directors and other senior managers, which can have a significant impact in reducing cases of financial and administrative corruption General People’s Congress.

The research findings

Through the examination and assessment of a number of concepts related to financial and administrative corruption and corporate governance, and by reviewing the various governance mechanisms used to deal with this serious issue, a number of results have been achieved, which can be summarised as follows:

- The application of corporate governance is the most effective solution to address the phenomenon of administrative and financial corruption and ensure the rights of stakeholders inside companies and private investors.
- Corporate governance has a major impact and an influential role in protecting the interests of individuals, institutions and communities in many economic, legal and social aspects.
- Good corporate governance helps attract investment, whether foreign or local, reduce capital leakage, and fight corruption.
- Corporate governance helps in the development of fresh and effective systems to assess the performance of public institutions through the principle of accounting costs of material and non-material corruption, so as not to be an excuse to cancel the freeze on anti-corruption for the rise in costs for the of corruption plans.

Conclusion

In recent times, takes on the issue of financial and administrative corruption has changed and debates are no longer considered a taboo, especially after the issuance of the international convention against corruption. In addition, the private sector has contributed to a great extent in combating financial and administrative corruption and turning into an active participant in the process through the collective efforts to limit its effects.

The principles of corporate governance have become a central theme in the reform process as they seek a decentralised system that not only governs the relationship between owners, investors, creditors and managers, but also serves as an incentive for reform through the application of the best standards of transparency, accountability and legal frameworks, which would curtail financial and administrative corruption and minimise its effects.

References


46. Sarbanes- Oxley Act, signed into law on July 30, (2002) by President George W. “Bush, is aimed at protecting investors from corporations’ fraudulent accounting practices while mandating strict reforms to financial disclosures and stopping accounting fraud”.


48. The King Report (King *I) (1994) the most effective summary of the best international practices in corporate governance".


62. Sarbanes- Oxley Act, signed into law on July 30, (2002) by President George W. “Bush, is aimed at protecting investors from corporations’ fraudulent accounting practices while mandating strict reforms to financial disclosures and stopping accounting fraud”.


64. General People’s Congress. (2010). Law No. (9) “The promotion of investment firms in Libya”.

