JOURNAL OF PUBLIC ADMINISTRATION, FINANCE AND LAW

EDITORIAL BOARD

CONTENTS

PUBLIC ADMINISTRATION

SUSTAINABILITY MANAGEMENT IN ITALIAN LOCAL GOVERNMENTS: SOME CONSIDERATIONS ON THE RELATIONSHIP BETWEEN STRATEGY AND FINANCIAL EFFORT FROM AN EMPIRICAL ANALYSIS [1]

Fabio DE MATTEIS
Department of Management, Economics, Mathematics and Statistics
University of Salento
Lecce, Italy
fabio.dematteis@unisalento.it

Antonio COSTA
Department of Management, Economics, Mathematics and Statistics
University of Salento
Lecce, Italy
antonio.costa@unisalento.it

Daniela PREITE
Department of Management, Economics, Mathematics and Statistics
University of Salento
Lecce

Department of Public Management and Policy
SDA Bocconi – School of Management
Milan, Italy
daniela.preite@unisalento.it

Alessandra TAFURO
Department of Management, Economics, Mathematics and Statistics
University of Salento
Lecce, Italy
alessandra.tafuro@unisalento.it

***Abstract**: Is there a relationship between sustainability strategies and the financial efforts for their realization? This is a particularly complex question considering that sustainability has generated an intense academic and political debate. In order to contribute to the debate, the Authors investigate the*

[1] This article was prepared jointly by the Authors. However, it is possible to assign paragraph 1 to Antonio Costa, paragraph 2 to Daniela Preite, paragraph 4 to Alessandra Tafuro, paragraphs 3, 5 and 6 to Fabio De Matteis.

existence of a relationship between the strategies of local authorities in terms of sustainability and their translation into financial commitments. To this end, firstly, the paper shows the results of research that explores the sustainability strategies of a sample of the 20 Italian regional capital cities, through the content analysis of their Performance Plans. Secondly, the Authors present their elaboration of financial data related to the main dimensions of sustainability (environment and territory management, welfare area, economic development). Finally, they discuss the relationship between the two aspects surveyed (strategies and expenditures committed to sustainability) highlighting critical perspectives also for future research.
***Keywords**: sustainability, local government, accounting.*

1. INTRODUCTION

Terms like "Sustainability" and "Sustainable Development" are not easy to define. There are many papers in which different definitions have been proposed (Pezzey, 1992; Murcott, 1997). In fact, as stated by Homann (1996), there is not an exhaustive definition of sustainability, and trying to find one is a mistake in itself. They are very broad concepts, which have become the subject of a heated theoretical and political debate and the object of studies and research.

In the Brundtland Report of the United Nations World Commission on Environment and Development (WCED, 1987), sustainable development is defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

Moreover, sustainable development "is not a fixed state of harmony, but rather a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are made consistent with future as well as present needs".

Sustainability becomes, therefore, a precondition for the conservation of sustainable development - that promotes social equity - both inside and outside of each local community - and intergenerational equity.

Considering these spatial and temporal aspects, in order to ensure sustainable development it is necessary to adopt a long-term plan that also takes into account the impact that it will have on future generations and, above all, that is the result of an integrated approach adopted to solve any problems that had previously been treated independently.

The concept of sustainable development was made official at the United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro in June 1992. During this event more than 170 governments signed a large document - called Agenda 21 - containing intentions and programmed objectives related to the environment, economy and society.

As part of the definition of Agenda 21, it was agreed that environmental goals should be combined with social, economic and institutional ones, thus giving rise to the three dimensions (pillars) in which the concept of sustainability is articulated:

▪ environmental, meaning the ability to preserve the quality and reproducibility of natural resources, while conserving biodiversity and ensuring the integrity of ecosystems;

▪ economic, as the ability to produce long term income and durable work in conditions of eco-efficiency, that is, with a rational use of available resources and an efficient exploitation of a non-renewable resources;
▪ social, understood as the ability to provide access to all the essential services (i.e. safety, health, education) and the conditions of well-being (entertainment, serenity, sociality), that should be equally shared between current and future generations.

A fourth dimension can be added to the above: the institutional dimension. This is the capacity to ensure stability, democracy, participation, information, education and justice in the community. This definition shows that institutional sustainability can be considered a part of the other three dimensions and therefore is contained in them and comes from them. Hence, the choice to dwell on the three traditional areas of sustainability.

These dimensions are closely interrelated through multiple connections and imply radical changes in individual behavior and in the choices of policy makers operating at different levels of government. Regarding this last aspect, which is the most important for this paper, Agenda 21 assigns a central role and specific powers to local governments (Local Agenda 21). Because so many of the problems and solutions addressed by Agenda 21 have their roots in local activities, the participation and cooperation of local authorities is a determining factor in fulfilling its objectives.

Local authorities construct, operate and maintain economic, social and environmental infrastructure, oversee planning processes, establish local environmental policies and regulations, and assist in implementing national and subnational environmental policies.

Local authorities, as the level of governance closest to the people, play a vital role in educating, mobilizing and responding to the public to promote sustainable development.

Each local authority should enter into a dialogue with its citizens, local organizations and private enterprises and adopt "a local Agenda 21". Through consultation and consensus-building, local authorities could learn from citizens and from local, civic, community, business and industrial organizations and acquire the information needed for formulating the best strategies. The process of consultation could increase household awareness of sustainable development issues.

Therefore, we cannot talk about sustainability and try to give a systematic theoretical and practical innovated development mode if it does not pay attention to the role played by a key actor of the process in question: public administration.

Public institutions, in fact, are particularly involved not only at the central level - where there are defined and approved plans and national and international programs on sustainability (Carter et al., 2011; Andrew et al., 2010; Rahaman et al., 2004) – but, especially at local level, where, by virtue of administrative decentralization and the autonomy principle (Borgonovi, 1996), municipalities, sometimes even of small or very small dimensions, govern the territory with their own rules and regulations.

The role of local government is essential: it is the institutional reference closest to the citizens and to economic and social organizations; it has the task of promoting a culture of sustainable development:

a) developing a comprehensive strategy that should be articulate on different levels;
b) leading, by its example, the behavior of the community.

Local public companies, on the one hand, must make available and share their experience, and on the other, must take an active and collaborative role in spreading the culture of sustainability and the implementation thereof.

The following considerations result from the need to reflect on an important aspect highlighted in literature that is to consider sustainability in the decision-making process in order to encourage the management of companies to have a sustainable behavior. If this consideration refers to the entire corporate world, we can say that, even at a local government level, the presence of so-called sustainable management is essential.

It can be argued that it is essential, within the local entities, that people in management have the necessary skills and are able to integrate into their guidelines and policy documents the principles of sustainable development that have inspired the acts signed during international summits.

In this perspective, this paper empirically examines whether, within the strategic planning documents of the Italian regional capital cities, (no.20), the objectives of sustainability have a place or not. Besides this, it investigates the level of financial commitment of local governments through the analysis of data in the financial report of 2011-2013. Finally, some considerations are made regarding the correlation between programming of sustainability and level of financial commitment of the same.

We believe that the analysis of the programmatic aspects is essential.

In order that political leaders and management in local government begin to act responsibly in terms of sustainability, urging them to question themselves about their institutional function, how to carry out their mandate and their ability to make decisions for the community that also look towards the future. That is, they must make choices which take into consideration the value and importance of sustainability, also from a strategic point of view (Tolba, 1997; Economic and Social Commission for Asia and the Pacific, 2004), and which are attributed to sustainability.

Choices, then, that should no longer sacrifice, as in the past, a medium to long term vision in favor of those aimed at achieving immediate political results.

Similarly, we believe that the focus on sustainability can be useful to rationalize the use of financial resources: plan sustainably to spend sustainably. For this reason, an analysis on the costs related to sustainability in local government was carried out.

The development of a concrete relationship between planning and spending for sustainable development requires a profound cultural and organizational change in the way we manage the public administration through an innovative, shared, planned and sustainable model (Bruff, Wood, 2000).

The desire is to have local governments that are more open to dialogue, more transparent and able to integrate the criteria of efficiency, effectiveness and economy – consolidated in the business management doctrine – with that of sustainability (Hood, 1995; Behn, 1998; Parker and Gould, 1999; Barzelay, 2001; Pollitt and Bouckaert, 2002). In this sense, Ball warns about the possibility that management of local authorities might make the mistake of focusing attention on short term actions - designed to achieve an adequate level of efficiency - to the detriment of long term goals, such as those related to sustainability (Ball, 2002).

The remainder of the paper is organized as follows. The next section defines the conceptual framework based on the literature on sustainability and presents our research questions. Section 3 outlines the adopted research methods. Sections 4 and 5 present the results of the analysis. Finally, Section 6 provides the conclusions and raises a number of critical issues for future research.

2. CONCEPTUAL FRAMEWORK

Since 1987, the academic and institutional worlds have raised the level of awareness on issues relating to sustainability, which, as evidenced by Bebbington and Gray (2001), was awarded a special place in the political agenda of many countries. Policy makers, as reflected in the work of Rogers, Jalal and Boyd (2008), were invited to combine, in the preparation of their agenda, the protection of the natural environment with the economic and social needs of the community. However, according to Strange and Bayley (2008), to achieve a concrete result in terms of sustainability, it is fundamental that the sustainability criteria in policy making is adopted at the different governmental levels, from international to local. Otherwise, achieving this goal remains a mere utopia.

The lack in the literature of specific research related to sustainable guidelines of public institutions was noted in the works of Ball (2002, 2004) and Ball and Grubnic (2007), which, however, highlighted the importance that studies on sustainability principles and practices can have in this area. Moreover, Gray (2006) shows the disparity in the number of jobs promoted in the public sector versus private (Andrew and Cortese, 2013; Spence et al., 2013; Cho and Patten, 2013; Michelon, 2014).

All this seems to contrast the consideration given in the Introduction, related to the contribution of the public sector in sustainable development by virtue of its nature and, thus, the execution of its functions through a sustainable approach (Brugmann, 1996; Kelly et al., 2004).

Public sector organizations, by definition, should generate value for society through their political choices. Therefore, their great responsibility is evident not only in adopting sustainable choices, but also in terms of promotion and support of policies that encourage sustainability. In this regard, as shown in the work of Ball and Grubnic mentioned above, an example of a tool used in the public sector to support sustainability is represented by the practice of Green Public Procurement (GPP), through which public administration takes into account environmental aspects in the purchasing process.

Research on sustainability strategy planning is still limited. Williams (2002) proposes the integration of sustainable development in the strategic planning process, as well as in the other processes that follow it.

With regard to Italian literature, we can point out the work of Mazzara et al. (2010a, 2010b). They analyzed the practices used in local authorities considering sustainable development in a strategic point of view and presented a first analysis regarding the consideration of sustainable development in the strategic plans of local authorities.

In general, it could be argued that the implementation of a planned activity should be supported by the elaboration of a strategy that specifies:
- the objectives and the explicit purposes of policies;
- the responsibility of all parties involved;
- the human and financial resources to be used;
- the appropriate control mechanisms to monitor the results achieved and any deviations from the planned objectives.

Based on the conceptual framework and debate discussed above, we pose the following research question:

RQ1: do the Italian local governments include sustainability strategies in their planning documents?

In comparison to the strategic aspect, the reporting aspect is more widely treated by Authors, both Italian and international (Broadbent and Laughlin, 2003; Dumay et al., 2010; Williams et al.,, 2011; Farneti, 2012). In fact, both national and local Public administration, having to follow different recommendations and to submit to numerous controls, appear to be more facilitated in and focused on reporting action undertaken and, consequently, on the performance achieved in terms of sustainability. But there are several Authors who show the existence of other factors that have contributed to the proliferation of writings on sustainability reporting in local authorities. For example, in the study by Kaur and Lodhia (2014) stakeholder engagement is considered an essential motivation for the development of sustainability reporting. The same approach is evident in the work by Farneti and Guthrie (2009) in which, with reference to the Australian public sector, it was found that sustainability reporting is justified by the need to inform the parties interested in organization activities.

Moreover, according to Ball and Bebbington (2008), for public organizations, sustainability transparency is an essential variable due to their nature. For the same Authors, in general terms, the performance of public organizations is often related to the achievement of their objectives that are socially sustainable. Through sustainability reporting public organizations have, at their disposal, a tool to monitor their strategies and guide future actions.

Hence the need for greater attention and diffusion of the control that closes the programming cycle and allows public organizations to have data related to management choices and their evolution with particular reference to:
- incurred expenditures;
- achieved results;
- deviations from planned objectives (identifying causes of these deviations).

The specific attention paid to financial dynamics - especially on sustainability expenditures - requires a reference to the role, the potential and the critical issues arising from the implementation of an environmental and social accounting system (Sargiacomo, 2014; Baker, 2014; Robert and Wallace, 2015).

Given the debate over the reporting on sustainability, we pose the following research question:

RQ2: How is sustainability strategies of local governments translated into their financial reports?

These assessments are complex, but important to check the decision-making process, because they imply the ex post re-examination of the targets identified in the programming documents, defining their continuation, elimination or reformulation according to the criteria of efficiency, effectiveness, and sustainability.

Research method

To answer the above-mentioned research questions, we did an exploratory study of a sample represented by 20 Italian regional capital cities, selected in order to:
- identify the most populous local governments;
- ensure a homogenous geographic distribution of the sample throughout the entire Italian territory.

Table 1: Sample

n.	Cities	Population
1	Aosta	34.901
2	Campobasso	49.392
3	Potenza	67.403
4	L'Aquila	70.967
5	Catanzaro	91.028
6	Ancona	101.742
7	Trento	117.285
8	Cagliari	154.019
9	Perugia	166.030
10	Trieste	204.849
11	Venezia	264.534
12	Bari	322.751
13	Firenze	377.207
14	Bologna	384.202
15	Genova	596.958
16	Palermo	678.492
17	Torino	902.137
18	Napoli	989.111
19	Milano	1.324.169
20	Roma	2.863.322

Regarding the first research question, we used the methodology of content analysis applied to the documents designated to represent the strategies of the local governments of the sample (three-year Performance Plan), in order to detect the degree of attention paid to sustainability strategies. We used - as part of the methodology of content analysis - the frequency analysis technique according to Krippendorff (1980).

Therefore, for each municipality of the sample, in the Transparency Area of the Institutional website, we accessed the section "Performance Plan" to download the document relating to the years 2011-2012-2013.

With reference to the second research question of this study, we used the document analysis procedure on the reporting documents that include the expenses related to sustainability.

In particular, we considered the financial report of the investigated local governments and, specifically, the functions related to the environment and territory management, welfare and economic development, because these represent the three dimensions of sustainability considered in this paper (environmental, social and economic). From a temporal point of view, the years investigated are 2011-2012-2013.

4. PERFORMANCE PLAN AND SUSTAINABLE STRATEGIES

The first step for making a content analysis is the acquiring of the documents on which to carry out the analysis. It was verified whether local government websites host a section dedicated to performance in which the Performance plan is found.

With regard to this first step, we found that, although public entities are obliged to have this section on their websites, some administrations have not complied with this formality. In fact, we did not find any reports for the municipality of Potenza and, consequently, the sample was reduced to 19 units.

This situation highlights a first critical aspect related to the existence of an information gap still to be filled in relation to some content that, instead, is necessary for the complete realization of the principle of transparency according to the criteria of easy accessibility, completeness and ease of consultation imposed by law (art. 1, paragraph 15 of Law 190/2012).

Given research question #1, for each institution we downloaded the Performance plan with the objective of verifying whether public administrators have included sustainability and the sustainable development among the main objectives to be achieved in the planning policy document of the city.

In the section of the municipal website dedicated to performance, we noted that the documents of interest for our survey are not similar to each other. This outcome is due to the autonomy that the law recognized to local authorities regarding the definition of the structure and content of the three-year performance plan report. In addition, the most recent legislation (Decree Law no.174 of 2012) gives local governments the choice to merge the performance plan with the Management Executive Plan. This alternative creates further confusion, especially when considering that the two documents have different purposes.

The analysis shows that in the performance area various documents, related to the following categories, are inserted:

- Performance Plan (2 entities);
- Goal Plan (5 entities);
- Management Executive Plan (6 entities),

- integrated document including the performance plan and the Management Executive Plan (3 entities);
- joint document including the Management Executive Plan and the Goal Plan (1 entity);
- document that correlates the performance plan to the Forecasting and Planning Report (2 entities).

This initial evidence highlights the need to reflect on critical issues, both formal (the number of documents used to illustrate the Institution's strategies) and substantial (heterogeneous data and information contained in the documents).

We have also noted heterogeneity in relation to another element: the period to which the documents refer which is fixed by law in three years.

It should be noted, in this regard, that the three-year performance plan should include both the strategic and operational objectives, specifying the objectives assigned to each of the three years.

The analysis revealed that:

- no.2 entities indicate in the title a three-year period, while the contents of the report refer to a single year (2013);
- no.14 entities explicitly indicate a single year reference period (2013).
- no.3 entities indicate instead a three-year period subdivided into a single years, as specified by law.

This consequently, invalidates the pluriannual nature of the programming that is particularly important in terms of sustainable development, whose essence is taking care of the intergenerational impact of the activity carried out and realization requires a period of medium / long term.

It is clear, therefore, that the choice is based on the least complicated and faster achieved goals, without considering the long-term sustainability of the same.

As provided by law (art.5 of Legislative Decree no.150/2009) the goals indicated in the Performance Plan must be scheduled every three years, must be defined at the beginning of the first year of the three year period, and are set out by the political and administrative bodies, after consulting the managers of the public organizational units. The same goals, however, must be defined considering the financial resources resulting from the approved budget.

A further reflection takes into consideration the date of approval of the strategies' programming documents. This date is often postponed to the last months of the year simultaneously with the approval of the annual budget.

It is obvious that this issue raises concerns about - especially when the documents only refer to the 2013 - the real programmatic capacity of the performance plans that are approved in a later date than the year to which the plan refers.

The implications arising from this fact cannot but have a negative impact on the overall activities of the entity which is essentially driven by the contingencies of a short or very short time.

For the content analysis, we used the more traditional technique of the analysis of frequencies, namely we counted how many times the terms “sustainability” and “sustainable development” occur in the documents.

The analysis of the text showed that:
1) Only six local government have adopted the term "sustainable development" their documents;
2) the expression "sustainable development" is always used in the introduction of the documents as a guiding principle of action of the Administration, but it is not indicated as a specific goal;
3) the adjective "sustainable" is associated with: a) construction (public housing) (no.4) characterizing, in fact, social policies in this area; b) tourism and economic activities envisaged in this area, considered a driving force for the economy of certain cities (no.3); c) mobility (no.7), in order to make choices to reduce traffic and facilitate the movement of citizens without resorting to cars;
4) considering the dimensions of "sustainable development", particular emphasis is given to environmental sustainability in 10 reports, where actions are explicit about: a) the restoration and preservation of the environment indicating, mainly, reclamation activities, the incentive of recycling and proper waste management, and those aimed at the reduction of pollutants;
b) the energy qualification of municipal buildings and structures used for public lighting.

These findings lead us to make some general reflections.

The first is that the concept of sustainable development has not yet been absorbed in the strategic objectives of the local authorities.

As aforesaid, the term appears with a very low frequency and, in any case, where it is found it is not considered for purposes of the actual programming.

A second consideration is the increased attention given to the environmental dimension rather than the others (social and economic dimensions). This circumstance is probably the most immediate consequence of the different legal obligations that bind the municipalities to implement specific practices, also in regard to the European commitment taken by the Italian government.

Finally, the analyzed planning documents, in their diversity, have been the main limitation of this analysis.

The absence of a single format of the report, as well as the autonomy left to the entities in the selection of the programming document to be drawn up, does not allow us to perform a precise comparison between entities, nor easily detect the number of the environmental / social / economic objectives out of the total number of targets formalized in the investigated documents.

This deeply undermines the transparency of the documents in which it is not clear whether or how individual institutions have actually formalized their strategies in terms of "sustainable development".

5. FINANCIAL ANALYSIS

The analysis considers the financial commitments contained in the three financial report sections related to the main dimensions of sustainability (environment and territory

management, welfare and economic development). Please note that the sample is made up of 19 organizations because of the unavailability of financial data of the city of Aosta.
For each of the three sections, the impact of expenditure commitments on the total current expenditure amount is assessed, in order to highlight the financial "weight" of each sustainability dimension and, therefore, to speculate the response to research question no.2 (the financial impact of the sustainability strategies). In the following tables, the increasing order of data is driven by the impact value of the most recent year available (2013).

The impact of expenditure commitments for environment and territory management on the total current expenditure amount is shown below.

Table 2: Impact of expenditure commitments for environment and territory management

			Environment and territory management (financial commitments)			Expenditure commitments for environment and territory management/total current expenditure		
	City	Population 2013	2011	2012	2013	2011	2012	2013
1	TRENTO	117.285	17.664.218	18.765.462	16.897.648	10%	11%	10%
2	L'AQUILA	70.967	116.986.765	67.066.456	26.806.266	46%	38%	12%
3	TRIESTE	204.849	39.797.253	40.003.874	44.211.518	14%	14%	14%
4	MILANO	1.324.169	380.125.311	429.672.482	427.938.987	16%	17%	16%
5	BOLOGNA	384.202	85.350.318	83.223.743	88.443.688	19%	18%	19%
6	ROMA	2.863.322	928.610.892	1.212.778.603	912.169.854	21%	25%	19%
7	TORINO	902.137	225.296.491	224.988.827	223.584.073	19%	19%	19%
8	FIRENZE	377.207	32.210.299	124.753.856	120.650.385	7%	22%	21%
9	VENEZIA	264.534	33.406.966	33.157.840	128.331.911	7%	7%	22%
10	ANCONA	101.742	23.948.408	24.964.312	24.401.236	22%	22%	22%
11	POTENZA	67.403	17.307.012	19.222.137	19.083.593	21%	24%	23%
12	GENOVA	596.958	150.310.673	164.513.342	164.535.720	21%	22%	24%
13	BARI	322.751	85.542.811	82.305.471	83.468.249	27%	26%	25%
14	PALERMO	678.492	174.782.867	174.093.823	186.553.371	22%	25%	26%
15	NAPOLI	989.111	231.232.330	236.817.140	324.281.085	19%	20%	26%
16	CAGLIARI	154.019	51.717.683	53.064.952	54.330.268	26%	29%	27%
17	PERUGIA	166.030	43.222.057	45.392.332	52.079.500	25%	27%	29%
18	CAMPOBASSO	49.392	14.701.730	14.986.061	14.733.410	32%	32%	32%
19	CATANZARO	91.028	26.547.142	26.751.605	25.238.867	33%	37%	34%

The data in the table show:

• very high values of expenditure commitments in the environmental field (eg., in 2013, from a minimum of 16 million euro for Trento, to 912 million euro for Rome);

• a marked variability of the impact on total current expenditure that, for example, in 2013 shows a gap of over 20 percentage points between the city with the minimum incidence (Trento, 10%) and the one with the highest impact (Catanzaro, 34%);

• a consistent level of the impact on total current expenditure (in more than half of the cities of the sample it exceeds the 20%), indicating a significant financial commitment of these organizations to issues relating to environment and territory management;
• a variability of the impact for each city in the three years considered, that, in many cases, is relatively limited (eg.: Trento, Milano, Bari), but in others is more consistent (Firenze, L'Aquila, Venezia).

The table below shows the impact of expenditure commitments in welfare on the total current expenditure amount, focusing, therefore, on the financial weight of the social dimension of sustainability.

Table 3: Impact of expenditure commitments in welfare

			Welfare (financial commitments)			Expenditure commitments in Welfare/total current expenditure		
	Comune	Population 2013	2011	2012	2013	2011	2012	2013
1	POTENZA	67.403	6.082.973	3.822.909	5.254.620	7%	5%	6%
2	CATANZARO	91.028	8.813.973	4.099.949	5.018.037	11%	6%	7%
3	NAPOLI	989.111	95.578.160	96.899.622	96.899.290	8%	8%	8%
4	PALERMO	678.492	66.653.378	62.180.336	62.388.413	9%	9%	9%
5	CAMPOBASSO	49.392	4.973.871	4.185.924	4.526.945	11%	9%	10%
6	GENOVA	596.958	81.027.865	79.769.446	78.894.687	11%	11%	11%
7	PERUGIA	166.030	22.136.095	21.251.479	21.479.344	13%	13%	12%
8	ROMA	2.863.322	690.664.330	693.703.018	660.020.124	15%	14%	14%
9	VENEZIA	264.534	89.212.118	84.114.306	84.569.141	18%	17%	14%
10	MILANO	1.324.169	397.789.451	388.324.555	391.160.416	17%	16%	15%
11	BARI	322.751	51.202.989	49.336.050	51.687.917	16%	15%	16%
12	ANCONA	101.742	17.868.916	17.324.204	17.083.678	16%	15%	16%
13	FIRENZE	377.207	99.666.663	97.572.899	98.446.280	21%	17%	17%
14	TORINO	902.137	267.077.516	249.695.638	243.962.944	22%	21%	21%
15	BOLOGNA	384.202	103.218.709	100.318.296	101.594.630	23%	22%	22%
16	CAGLIARI	154.019	44.390.843	40.225.563	45.743.084	22%	22%	23%
17	TRENTO	117.285	56.918.920	52.712.896	51.026.802	31%	30%	29%
18	TRIESTE	204.849	89.983.410	92.350.324	92.562.589	32%	32%	30%
19	L'AQUILA	70.967	86.060.301	59.782.385	122.727.650	34%	34%	57%

The analysis of data denotes that:
• the absolute value of current spending commitments for welfare ranges from about 5 million euro (Catanzaro) to over 660 million euro (Rome);
• the impact of welfare expenditure on total current expenditure (in 2013) oscillates from a minimum of 6% (Potenza) to a maximum of 57% (L'Aquila). Among the lower impact values there is the City of Potenza (as in the analysis of the absolute values, together with Catanzaro and Campobasso). On the contrary, the highest impact occurs in the city of L'Aquila while, in absolute terms, the municipality with the highest value of financial commitment is Rome.

Finally, the next table highlights the impact of expenditure commitments in economic development on the total current expenditure amount, investigating the third dimension of sustainability.

Table 4: Impact of expenditure commitments in economic development

			Economic Development (financial commitments)			Expenditure commitments in Economic Development / Total current expenditures		
	City	Population 2013	2011	2012	2013	2011	2012	2013
1	L'AQUILA	70.967	51.181	46.440	63.408	0%	0%	0%
2	NAPOLI	989.111	2.855.164	2.296.510	2.276.098	0%	0%	0%
3	POTENZA	67.403	293.123	266.903	223.474	0%	0%	0%
4	BOLOGNA	384.202	1.607.256	1.253.034	2.340.269	0%	0%	0%
5	PERUGIA	166.030	1.421.735	936.369	973.317	1%	1%	1%
6	MILANO	1.324.169	12.417.885	21.759.559	14.831.679	1%	1%	1%
7	PALERMO	678.492	4.238.518	4.415.546	4.103.670	1%	1%	1%
8	ROMA	2.863.322	35.421.028	32.810.788	30.209.922	1%	1%	1%
9	VENEZIA	264.534	4.369.726	3.477.264	3.776.312	1%	1%	1%
10	BARI	322.751	3.183.723	2.851.635	2.693.214	1%	1%	1%
11	TORINO	902.137	11.521.241	11.710.148	11.752.373	1%	1%	1%
12	TRIESTE	204.849	4.085.799	3.688.869	3.247.598	1%	1%	1%
13	CAMPOBASSO	49.392	559.957	644.204	496.953	1%	1%	1%
14	ANCONA	101.742	1.369.831	958.026	1.272.998	1%	1%	1%
15	FIRENZE	377.207	7.404.289	6.702.303	7.519.978	2%	1%	1%
16	GENOVA	596.958	9.650.786	8.782.552	8.936.633	1%	1%	1%
17	TRENTO	117.285	1.140.097	1.107.410	2.535.526	1%	1%	1%
18	CATANZARO	91.028	1.460.753	1.372.288	1.331.745	2%	2%	2%
19	CAGLIARI	154.019	5.720.474	4.969.509	5.107.931	3%	3%	3%

The analysis of financial values highlights that:

• the absolute values of financial commitments in the area of economic development are lower than those seen for environment and welfare;

• the impact of expenditure commitments for the economic development on the total current expenditure is at low level (within 3%);

• the impacts in question are fairly homogeneous among all the cities of the sample showing a low gap between the minimum and the maximum value.

5.1 FINANCIAL INDEX OF SUSTAINABILITY STRATEGY IMPLEMENTATION

In this paragraph, again to clarify the possible answer to research question no.2, financial analysis focuses on an indicator which highlights the degree of implementation of sustainability strategies (here defined as financial index of strategy implementation). It is calculated as the ratio between payments for the period (for each of the three dimensions considered) and the related financial commitments.

The following table contains the implementation index related to Environment and territory management.

Table 5: Implementation index - Environment and territory management

		Environment and territory management (payments / financial commitments)		
	City	2011	2012	2013
1	NAPOLI	23%	20%	20%
2	POTENZA	36%	35%	43%
3	TORINO	34%	42%	43%
4	CATANZARO	44%	45%	48%
5	FIRENZE	51%	51%	51%
6	TRENTO	58%	56%	51%
7	CAMPOBASSO	61%	56%	58%
8	MILANO	69%	66%	68%
9	L'AQUILA	87%	79%	71%
10	PERUGIA	85%	65%	73%
11	ANCONA	77%	76%	77%
12	ROMA	72%	65%	79%
13	PALERMO	86%	86%	79%
14	CAGLIARI	75%	82%	80%
15	VENEZIA	90%	86%	80%
16	BARI	81%	84%	82%
17	BOLOGNA	83%	88%	89%
18	TRIESTE	87%	78%	90%
19	GENOVA	91%	90%	94%

As evidenced in the previous table, there is a large gap between the minimum value of the financial index of environment strategy implementation (20%, Naples for 2013) and the maximum (94%, Genova for 2013).

The following table sets out the financial index of welfare strategy implementation.

Table 6: Implementation index - Welfare

		Welfare (payments / financial commitments)		
	City	2011	2012	2013
1	NAPOLI	35%	21%	22%
2	L'AQUILA	86%	69%	34%
3	POTENZA	30%	38%	49%
4	PALERMO	54%	47%	49%
5	BARI	60%	56%	53%
6	CAMPOBASSO	53%	48%	53%
7	TORINO	73%	63%	55%
8	ROMA	59%	58%	58%
9	PERUGIA	59%	59%	62%
10	ANCONA	65%	66%	65%
11	BOLOGNA	66%	76%	67%

12	CATANZARO	56%	69%	70%
13	FIRENZE	66%	71%	71%
14	MILANO	68%	69%	71%
15	CAGLIARI	66%	72%	76%
16	TRIESTE	;378%	78%	79%
17	GENOVA	82%	82%	83%
18	TRENTO	84%	83%	85%
19	VENEZIA	78%	87%	87%

The empirical evidence shows that the implementation of social strategies (from a financial point of view) assumes percentages that are rather consistent with a wide oscillation that goes from 21% for Napoli in 2012 to 87% for Venezia in the same year. Finally, the financial index of implementation of the economic development strategy is determined.

Table 7: Implementation index – Economic development

		Economic development (payments / financial commitments)		
	City	2011	2012	2013
1	TORINO	68%	73%	61%
2	BOLOGNA	77%	100%	61%
3	CAMPOBASSO	54%	41%	62%
4	L'AQUILA	57%	59%	67%
5	MILANO	84%	65%	68%
6	CATANZARO	84%	88%	68%
7	ANCONA	63%	91%	69%
8	BARI	69%	75%	72%
9	POTENZA	76%	97%	72%
10	CAGLIARI	67%	79%	73%
11	GENOVA	76%	78%	76%
12	NAPOLI	78%	80%	76%
13	FIRENZE	72%	79%	80%
14	ROMA	66%	72%	81%
15	TRIESTE	81%	82%	82%
16	PALERMO	92%	82%	88%
17	TRENTO	69%	67%	91%
18	PERUGIA	80%	91%	94%
19	VENEZIA	81%	96%	94%

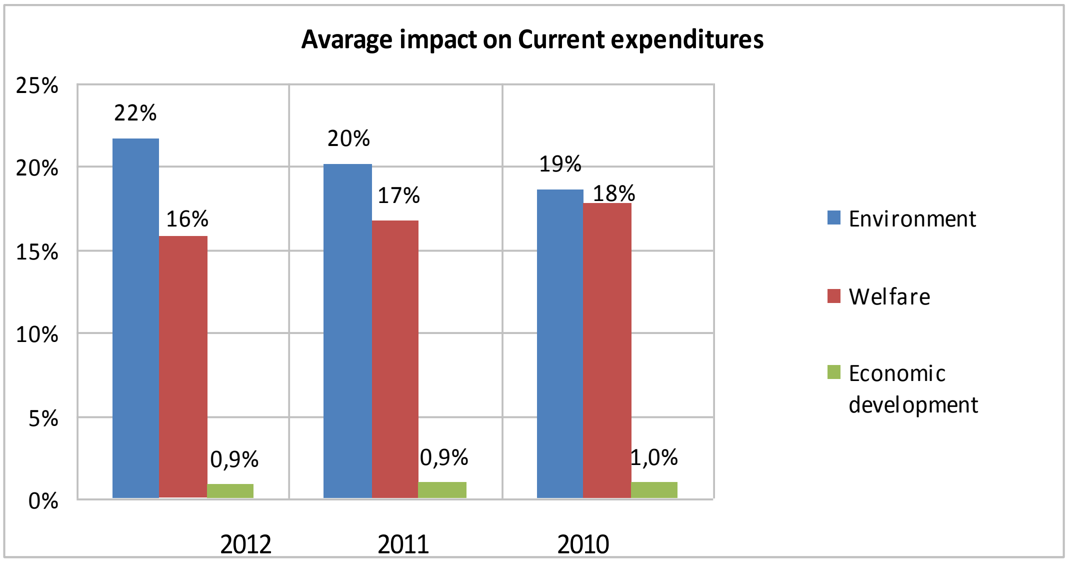
What seems evident from the data shown above is that the value of the financial index of economic strategy implementation takes on particularly large values (i.e., greater than 61% in 2013, 41% in 2012 and 54% in 2011).

5.2 The sustainability dimensions in comparison

This section analyzes the financial ratios resulting from the two preceding paragraphs in their average value for the sample considered, in order to compare, synthetically and jointly, the three dimensions in which sustainability can be divided.

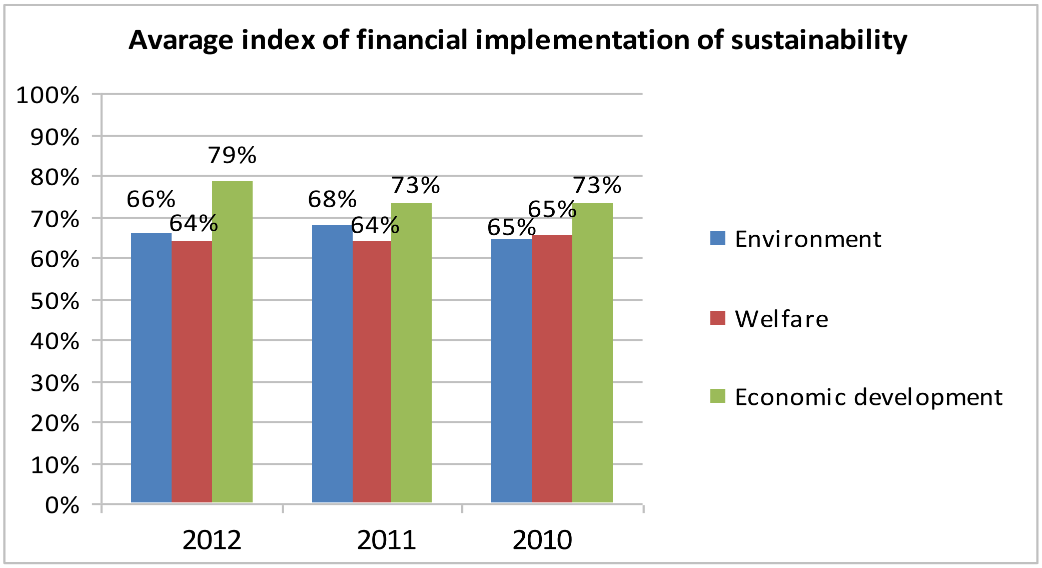
It seems clear that the expenditures for the environmental and welfare dimensions have an average impact on total current expenditures that is far greater than the impact of economic development expenditure. Financially, this shows a greater attention of analyzed local governments on environmental and social issues, while only a marginal commitment is dedicated to the support of economic activity. This situation is almost constant in the period considered.

Figure 1 Avarage impact on current expenditures



The graph below shows that the average index of financial implementation of sustainability is quite high for the three dimensions that make up the same. Moreover, there is a greater level of implementation of the economic development aspects of sustainability for which, in the period considered, the implementation index goes from 73 % in 2011, to 79 % in 2012 and reaches 75% for 2013. While, the implementation index, for the welfare and environmental dimensions - during the three years considered - assumes values comprised between 60% and 68%.

Figure 2 Average index of financial implementation of sustainability



6. CONCLUSION, DISCUSSION AND WAYS FORWARD

From the joint examination of the results of the two empirical analyses carried out previously, some observations arise. In particular, the content analysis on the strategic documents of the local governments in the sample and the examination of their accounting data, provide information for evaluating whether and what kind of consistency there is between sustainability strategies and financial commitments in sustainability dimensions.

Thus, there is:

1. great autonomy in formulating strategies, highlighted by the different programming documents found analyzing the sample. The positive aspect of this autonomy is to possibility to select the content (and so also in terms of sustainability) and the mode of representation of the strategies that is most suited to the specific situation of the local government. The critical aspect comes from the strong bureaucratic culture that still persists in public organizations. So, if there is not an imposed model for the strategy representation - which, in turn, enforces the formalism – the definition of strategy itself is undervalued. This emerges from the analysis of the Performance Plans which, in effect, consist of other documents (Management Executive Plan, Goal Plan, etc.). Besides, these documents, considering a single year, lose the strategic approach and, in particular, heavily penalize the focus on sustainability which involves a multiannual view;
2. little attention to sustainability in the documents analyzed. In fact, a first examination of the contents of these documents highlights that the main terms related to sustainability are rarely used;
3. particular importance, from a financial point of view, given to the environmental and welfare sustainability dimensions, both in relation to the total current expenditure

committed (on average between 18% and 22% in 2013), and in terms of financial implementation (on average between 63% and 67%). The expenditure impact for economic development is much lower, while the average level of financial implementation of the same is higher;

4. a discrepancy between the limited strategic consideration of the sustainability dimensions and their financial implications that, as empirically shown, are considerable. This shows how large sums of public money intended for environmental, social and economic aspects are spent without a prior strategic vision and without the necessary management knowledge of these issues, risking financial waste and inefficiency.

In brief, the statement points to the need for a greater sustainability culture and a deeper attention to the same, through its inclusion in the strategic and operational objectives of local authorities. Therefore, a closer coherence between these objectives and the financial dynamics related to sustainability is necessary, so that the attention paid to sustainability in the planning phase does not remain purely formal and disconnected from the local government financial commitments.

In order to provide additional contributions to the scientific debate, as well as support to those in local public organizations involved in sustainability management, the optimization of the analysis needs to expand the research conducted examining the following items:

• per capital expenditure values, relating the expenditures for the sustainability dimensions to the resident population and making the comparisons between local governments more objective;

• capital expenditures related to the sustainability dimensions. In addition to the current expenditures already considered, the examination of capital expenditures would allow us to discuss public investment in sustainability;

• the contents of the programming documents already considered through an in-depth analysis of the same in order to better understand their focus towards sustainable development (e.g. by comparing the number of targets relating to the sustainability to the total number of planned objectives).

References

1. Andrew, J., Kaidonis M.A., & Andrew B. (2010). *Carbon tax: Challenging neoliberal solutions to climate change*, Critical Perspectives on Accounting, 21(7), 611–618.
2. Andrew, J., & Cortese C. (2013). *Free market environmentalism and the neoliberal project: The case of the Climate Disclosure Standards Board*, Critical Perspectives on Accounting, 24(6), 397–409.
3. Baker, C. R. (2014). *Breakdowns of accountability in the face of natural disasters: The case of Hurricane Katrina*, Critical Perspectives on Accounting, 25(7), 620–632.
4. Ball, A. (2002). *Sustainability accounting in UK local government: An agenda for research*, Association of Chartered Certified Accountants (ACCA), Research Report, n. 78.
5. Ball, A. (2004). *A Sustainability Accounting Project for the UK Local Government Sector? Testing the Social Theory Mapping Process and Locating a Frame of Reference*, Critical Perspectives on Accounting, 15(8), 1009-1035.

6. Ball A., & Grubnic S. (2007). *Sustainability accounting and accountability in the public sector*, Unerman J., Bebbington J., O'Dwyer B., Sustainability Accounting and Accountability, Routledge, London.
7. Ball, A., & Bebbington, J. (2008). *Accounting and Reporting for Sustainable development in Public Service Organisations: issues and emerging directions*, Public Money and Management, 28(6), 323-325.
8. Barzelay, M., (2001), *The New Public Management. Improving Research and Policy Dialogue*, University of California Press, Berkeley.
9. Bebbington, J., & Gray, R. (2001). *An Account of Sustainability: Failure, Success and a Reconceptualisation*, Critical Perspectives on Accounting, 12(5), 557-605.
10. Behn, R. D. (1998). *The New Public Management Paradigm and the Search for Democratic Accountability*, International Public Management Journal, 1(2), 131-164.
11. Borgonovi, E. (1996). *Principi e sistemi aziendali per le amministrazioni pubbliche*, Egea.
12. Broadbent, J., & Laughlin R. (2003). *Control and legitimation in government accountability processes: the private finance initiative in the UK*, Critical Perspectives on Accounting, 14(1-2), 23–48.
13. Bruff, G., & Wood, A. (2000). *Local Sustainable Development: Land-Use Planning's Contribution to Modern LG, Journal of Environmental Planning and Management*, 43(4), 519-539.
14. Brugmann, J. (1996). *Planning for Sustainability at the local government level*, Environ Impact Asses Rev., 16, 363-379.
15. Carter, C., Clegg, S., & Wåhlin, N. (2011). *When science meets strategic realpolitik: The case of the Copenhagen UN climate change summit*, Critical Perspectives on Accounting, 22(7), 682–697.
16. Cho, C. H., & Patten, D. M. (2013). *Green accounting: Reflections from a CSR and environmental disclosure perspective*, Critical Perspectives on Accounting, 24(6), 443–447.
17. Dumay, J., Guthrie, J., & Farneti, F. (2010). *GRI Sustainability Reporting Guidelines for Public and Third Sector Organizations*, Public Management Review, 12(4), 531-548.
18. Economic and Social Commission for Asia and the Pacific. *Integrating economic and enviromental policies: the case of Pacific Island countries*, Development papers n. 25, United Nation, 2004.
19. Farneti, F. (2012). *La rendicontazione di sostenibilità negli enti locali*, RIREA, Roma.
20. Farneti, F., & Guthrie, J. (2009). *Sustainability Reporting by Australian Public Sector Organisations: Why They Report*, Accounting Forum, 33(2), 89-98.
21. Gray, R. (2006). *Social, Environmental and Sustainability Reporting and Organizational Value Creation: Whose Value? Whose Creation?*, Accounting, Auditing and Accountability Journal, 19(6), 793–819.
22. Homann, K., (1996). *Sustainability: Politikvorgabe oder regulative Idee?*, Gerken, L. Ordnungspolitische Grundfragen einer Politik der Nachhaltigkeit, (pp. 33-47), Baden-Baden: Nomos.
23. Hood, C. (1995). *The New Public Management in the 1980s: Variations on a Theme*, Accounting Organizations and Society, 20(2/3), 93-109.
24. Kaur, A., & Lodhia, S. (2014). *The state of disclosures on stakeholder engagement in sustainability reporting in Australian local councils*, Pacific Accounting Review: Special issue on Sustainability Accounting and Reporting, 26(1/2), 54-74.
25. Kelly, R., Sirr, L., & Ratcliffe, J. (2004). *Futures Thinking to Achieve Sustainable Development at Local Level in Ireland*, Foresight: The Journal of Futures Studies, Strategic Thinking and Policy, 6(2), 80-90.
26. Krippendorff, K. (1980), *Content analysis. An Introduction to its Methodology*, Beverly Hills, Sage.
27. Mazzara, L., Sangiorgi, D., & Siboni, B. (2010a). *Strategic planning in Italian local governments. A sustainability focus?"*, Public Management Review, 12(4), 493-509.

28. Mazzara, L., Sangiorgi, D., & Siboni, B. (2010b). *Lo sviluppo sostenibile in ottica strategica: un'analisi delle pratiche negli enti locali*, Azienda Pubblica, 23(3), 417-443.
29. Michelon, G., Pilonato, S., & Ricceri, F. (2015). *CSR reporting practices and the quality of disclosure: An empirical analysis*, Critical Perspectives on Accounting, in Press, Available online 15 November 2014.
30. Murcott, S. (1997). *What is Sustainability*?, Conference paper presented at AAAS Annual Conference; IIASA, Sustainability Indicators Symposium, Seattle, WA February 16, 1997.
31. Parker, L., & Gould G. (1999). *Changing Public Sector Accountability. Critiquing New Direction*, Accounting Forum, 23(2), 109-136.
32. Pezzey, J. (1992). *Sustainability: An Interdisciplinary Guide, Environmental Values*, 1(4), 321-362.
33. Pollitt, C., & Bouckaert, G. (2002). *La riforma del management pubblico*, Università Bocconi Editore, Milano.
34. Rahaman, A. S., Lawrence, S., & Roper, J. (2004). *Social and environmental reporting at the VRA: institutionalised legitimacy or legitimation crisis?* Critical Perspectives on Accounting, 15(1), 35–56.
35. Roberts, R., & Wallace, D. M. (2015). *Sustaining diversity in social and environmental accounting research*, Critical Perspectives on Accounting, in press, Available online 8 May 2015.
36. Rogers, P.P., Jalal, K.F., & Boyd, J.A. (2008). *An introduction to sustainable development*, Earthscan, London.
37. Sargiacomo, M. (2014). *Accounting for Natural Disasters & Humanitarian Interventions*, Critical Perspectives on Accounting, 25(7), 576–578.
38. Spence C., Chabrak N., Pucci R. (2013). *Doxic sunglasses: A response to ''Green accounting and Green Eyeshades: Twenty years later''*, Critical Perspectives on Accounting, 24(6), 469–473.
39. Strange, T., & Bayley, A. (2008). *Sustainable development. Linking economy, society, environment*, OECD Publishing, Paris.
40. Tolba, M. K. (1997). *Sustainable Development: constraints and opportunities*, Butterworths, London.
41. Williams, B., Wilmshurt, T., & Clift, R. (2011). *Sustainability reporting by local government in Australia: Current and future prospects*, Accounting Forum, 35(1), 176-186.
42. Williams, P.M. (2002). *Community Strategies: Mainstreaming Sustainable Development and Strategic Planning?*, Sustainable Development, 10(4), 197-205.
43. World Commission on Environment and Development (1987), *Our Common Future*, Oxford University Press, Oxford, U.K.

WAGE EROSION AND COMPRESSION IN THE NIGERIAN CIVIL SERVICES: IMPLICATIONS FOR PERFORMANCE

Samuel O. OYEDELE
Department of Public Administration
Faculty of Management Sciences,
University of Ilorin, Nigeria
samolaoyedele@gmail.com

Abstract: *The importance of wage or salary administration practice to the achievement of individual and group efforts in any organization cannot be over stressed. It is vital to the achievement of the corporate goal of any organization. Therefore, it is an important personnel management function. Perhaps, payment of wage and salary is the single most important obligation owed by an employer to an employee in organizations worldwide. However, the payment of salary in the state civil services, local government areas and even at the federal level in Nigeria has become problematic and hence worrisome today. This is as a result of the general economic down turn leading to inequitable pay or delay in payment or non-payment of salaries of civil servants coupled with high rate of inflation which constitute what this paper regards as wage erosion. This paper holds the opinion that this trend has grievous implications for the performances of civil servants and national development if not properly and promptly addressed.*
Keywords: *Wage or Salary; Wage Erosion, Implications for performance; Economic depression; Minimum Wage*

INTRODUCTION

Payment of wage/salary is the single most important obligation owed by an employer to an employee. However, wage/salary administration has always been the bone of contention in labour-management relations in Nigeria. Its etymological background is traceable to colonization in Nigeria right through to the attainment of political independence in 1960 and after (Maduabum 1998). Over the years, governments at the three levels (Federal, State and Local) in Nigeria have failed to respond appropriately to the realities of their changing economic environment. Thus, they had continued with the expansion of their civil services several years after independence. This development led to the sharp decline in government revenues while expenditures continued to increase particularly under civil rule with the addition of several political appointees to their pay rolls.

Added to this is the fact that there is a continuous and sharp decline in the prices of oil worldwide leading to a continuous and sharp decline in oil revenue to the country, as well as devaluation of the nation's currency, very high inflation rate and general economic hardship in the country. Therefore, in recent years, government at these levels had come face to face with the reality of badly declined resource base. Indeed, in recent years, it has become increasingly difficult and almost impossible for governments at all levels to pay decent salaries to civil servants regularly or to even pay at all, as many states and local governments and even the federal government are now owing their staff many months of salary. In fact, many state governments are considering the option of downsizing their work forces or reducing the salaries of their workers. This, according to some state governors is because their financial resources can no longer cope with the payment of the N18, 000 national minimum wage. The labour union on the other hand, opposed this proposal and has been agitating for an upward review of the national minimum wage on the ground that it has become grossly inadequate to meet their needs in the face of a high rate of inflation in the country.

The result of this development is that real wage level fell drastically resulting in severe wage erosion across the civil services in the country. Some of the major implications of this wage erosion is that the motivation, dedication to duty and ability of the civil services to attract and retain skilled and professional civil servants have declined greatly in recent times across the country. This is no doubt catastrophic for a developing country which aspires to achieve rapid national development. This is why this paper is concerned with the implications of this situation for the performances of civil servants. To achieve this objective, the paper is organized into four parts. The first part examines the concept and components of wage or salary. The second part discusses wage erosion and compression in Nigeria's civil services while the third part is the analysis of the major implications of wage erosion and compression for the performances of civil servants in the country. The fourth part is the concluding remarks.

THE CONCEPT AND COMPONENTS OF WAGE OR SALARY

According to Maduabum (1998), salary could be conceptualized as compensation received by an employee for services rendered during a specified period weekly, monthly, or yearly. Wage on the other hand, refers to compensation paid to an employee as stated sum per piece, day, or any other unit or period for services rendered. Essentially, wage and salary refer to money paid in concrete terms in return of job done. The two concepts could therefore be used inter-changeably to mean the same thing. Wage or salary is usually based on an agreement between the labourers who offers to sell his services to the management who in turn accepts to pay money in return for the services of the labourer. The monetary value of the services rendered by the employee depends on the quality of services rendered and effort put into such services by the employee.

As noted earlier, the importance of wage or salary to employees cannot be over stressed. Indeed, its administration is a major personnel management function which must receive adequate attention by any organization. Therefore, its importance must be well known by an organization if it is to be used effectively. Perhaps, wage or salary administration is the most important obligation owed by an employer to an employee in both private and public organizations all over the world today.

Anjorin (1992) contends that, in practice, wage and salary policy serves three principal needs. These are to: attract capable and sufficient employees to the organization; motivate employees towards superior performance; and to retain good employees. Organizations need to ensure that employees are satisfied with their pay. According to him, the three major determinants of satisfaction with salary or wage are: equity, pay level and pay administration practices. Pay equity refers to the relationship between what employees feel they should be receiving and what they are receiving. Pay level is a determinant of the perceived amount of pay compared to what should be received. Pay administration suggests that:

(i) The wages and salaries offered should be approximate the wages and salaries paid to other employees in comparable organizations in order to attract new employees and keep them; and
(ii) in order to enhance pay satisfaction, pricing of jobs should embody a philosophy of equal pay for equal work

As noted earlier, compensation, that is, the payment of wage or salary is any form of payment given to employees in exchange for work they provide their employer. The components of a compensation system are basically two. They are the direct and indirect compensation. Financial payment made at, or near the time work is performed is the direct compensation. This includes basic and incentive pay. Examples of direct compensation are wages, salaries, overtime pay, commission and bonuses. An employee paid on a monthly, semi monthly, or weekly basis receives a salary. Employees receiving a salary receive their pay regardless of the specific number of hours they work. Besides earning a wage or salary, most employees are also compensated for their efforts by certain benefits. Such benefits as paid vacation days and holidays, health care, insurance, and pensions are forms of deferred or indirect compensation (Stone, 1982). However, the basic pay, that is, wage or salary is the hob around which all other aspects of compensation revolve.

WAGE EROSION AND COMPRESSION IN THE NIGERIAN CIVIL SERVICES

One of the major ecological factors confronting public administration in Nigeria is the poor economic situation of the country. While public sector manpower has risen rapidly over the years, the economic fortunes of the country had fluctuated greatly with grave consequences for the performances of the civil services of the country. This development has impaired greatly, the contribution of civil servants at the three levels of government to nation-building and national development. For several decades, the country had depended heavily on oil as its major source of national revenue. Unfortunately, the world oil market prices have been highly unstable. According to Olowu (1991), since 1977, the oil sector has faced periodic oil gluts an since 1980, a gradual reduction in oil prices has ensued with the result that large-scale contraction (privatization, reduction in employee benefits and retirement) has had to be embarked upon in the public sector. The trend of this economic depression continued in the 1980s. From the mid – 1980s in Nigeria, government resource base had declined sharply. It became increasingly difficult to pay decent civil service salaries at all or pay salaries regularly, and as inflation level rose, aggravated by the adoption of Structural Adjustment Programme (SAP) that necessitated sharp currency devaluations, real wage levels fell by as much as 50 percent and sometimes more –resulting in severe wage erosion (Olowu and Adamolekun, 2005). Over the last few decades, the economic situation of the country has gone from bad to worse. Today, the economy of the country is still faced with many problems, amongst which are high inflation, rising interest rates, low productivity in the real sectors, inadequate foreign exchange, capacity under-utilization of industries, large external debt burden and import-dependence of the economy (Okunneye, 1985).

In the face of this perverse economic situation, the revenue accruable to the federal government continued to record huge shortfalls in recent years. This has resulted into hyper-inflation trends, massive fall in the value of the nation's currency among other economic hardship factors in the country. Consequent upon this hard economic realities, most states and local governments have become insolvent to the extent that they can no longer pay salaries of their civil servants as and when due.

It has therefore become increasingly difficult and almost impossible for governments at all levels to pay decent salaries to civil servants regularly or to even pay at all. This is because of a continuous and sharp decline in oil revenue to the country, devaluation of the nation's currency, very high inflation rate and general economic hardship in the country. The result is that real wage levels fell drastically resulting in severe wage erosion and depression across the country's civil services.

One major disturbing aspect of this situation is the recent pronouncement by the thirty-six State Governors that as a result of the deteriorating state of the economy, the State Governors were struggling to meet up with expenditure, especially payment of salaries, because of dwindling monthly allocations occasioned by plummeting crude oil, therefore, payment of N18, 000 minimum wage imposed on them is no longer bearable. According to the communiqué released by the Governors forum on 19th November, 2015, they were having a hard time meeting up with expenditure, especially payment of salaries because of dwindling monthly allocations occasioned by plummeting price of crude oil (Tribune, 21 November, 2015). They added that, the economic situation was worrying, as more states would reach a stage where they would not be able to pay salaries of civil servants not to talk of embarking on capital projects, infrastructures development and establishment of industries. Some State Governors are even contemplating on downsizing their workforce. The fact is that the cost of governance is high especially as every state depends heavily on the federal government's monthly revenue allocation for survival.

However, in a swift reaction to the resolution of the State Governors forum, the Nigeria Labour Congress and the Trade Union Congress of Nigeria warned that any attempt to undermine the payment of the N18,000 minimum wage by the State Governors will not be taken lightly by workers. According to the labour unions, the N18,000 minimum wage was not allocated to worker or imposed on State Governors, it was negotiated through a tripartite process hence, a product of law. They argued that the minimum wage was actually due for an upward review. The President of the Nigeria Labour Congress, Comrade Ayuba Wabba and his Trade Union Congress counterpart, Comrade Bobboi Kaigama, announced that if attempt is made to reduce, review downwardly or do anything outside of the legal minimum wage of N18, 000 which cannot even take workers home, workers will be mobilized to resist it by withdrawing their services and close down the country. (Tribune, 21 November, 2015). According to the Unions, the N18, 000 minimum wages is about eighty (80) US dollars per monthly salary – about 2.5 dollars a day. The fact is that, from an employee's perspective, the real value of pay depends on its actual purchasing power (Hays and Reeves, 1984).

The result of the delay or irregular payment of workers' salaries, low level of salaries, the proposed further reduction in salaries and the hyper inflation in the country all constitute wage erosion and compression that has serious implications for effective personnel management in general and the performance and productivity of the civil servants in particular.

THE IMPLICATIONS OF WAGE EROSION AND COMPRESSION FOR PERFORMANCE IN THE NIGERIAN CIVIL SERVICES

The importance of the civil services of any country to national development cannot be over emphasized. This is because a nation's civil services at federal, state and local government levels are the chief instruments for the implementation of the will of the state as expressed through public policy. They are indispensable to the functioning of the modern state. The new task of the civil servants are therefore comprehensive and include planning, control and guidance of the entire economic as well as social activities. The manner in which work is done and its efficiency now directly impinge on the lives of individual citizens. The welfare of the people will, to an increasing extent depends on the imagination and sympathy and the efficiency with which work is understood and done by the civil servants (Basu, 2012). Therefore, civil service performance is critical to the effectiveness and efficiency of government services. And since the effects and impact of these services are all pervading to every sector and segment of the nation, both public and private, civil service performance is probably the primary determinant of the nation's socio-economic development (Kiragu, 2000).

In view of the importance of the civil services of a country and the civil servants who man them as highlighted above, the salaries and wages of civil servants also constitute a very important factor and indeed sensitive to the well-being and productivity of the civil servants. This is because the health and vitality of civil services depend on the levels of remuneration. Therefore, the salary system must be so designed as to attract, motivate and retain the staff. The tempo of undertaking the challenging and arduous tasks by the government can only be hastened if it has the right number of employees with adequate skills in the proper place, at the proper time, performing the deserved activities to achieve the desired objectives (Basu, 2012).

However, as noted earlier, in the Nigerian civil service, the situation is that the wages paid have become grossly inadequate given the present poor economic situation and the high cost of living. According to Omotosho (2006), despite the increase in salary by the Obasanjo administration, the civil service salary in Nigeria is still very low. One of the major issues which have dominated the pay and benefits scene in personnel management particularly in developing countries of the world is the need to ensure that salaries are revised periodically in response to inflationary trends and in conjunction with the pay for comparative work in other sectors of the economy. This is the justification of the argument for a decent or living wage and for competitive pay to ensure that public service pay can attract and retain qualified professional and managerial staff (Olowu and Adamolekun, 2005).

Money is perhaps the number one motivator in Nigeria. Therefore, one of the major implications of this is that, if the pay level is too low to sustain an acceptable level of employee motivation and performance, workers either cut back their productivity or hours of work. They may seek to change jobs to the private sector. The issue of employee's motivation has become central in personnel management discourse today. This is because both the public and private sectors accept the need to ensure the safety of their employees, to provide satisfactory welfare services, and to establish working conditions that will attract good-quality personnel committed to the achievement of organizational objectives (Olowu and Adamolekun, 2005). The major theories of motivation emphasized the importance of employee motivation. For instance, Abraham Maslow's theory of hierarchy of needs regard physiological or basic needs (food, shelter and clothing; security and safety needs) as those needs that will ordinarily be covered by most employees. On the other hand, Frederick Herzberg regards the hygiene factors such as maintenance factors which cannot motivate employees but produce dissatisfaction if not present in a workplace. In the case of the Nigerian civil services, the basic needs of civil servants are not adequately taken care of, what more of the motivating factors such as recognition, promotions prospects or even self-actualization needs.

Another serious implication of wage erosion and depression in the civil services is that civil servants will adjust their workplace attitude to this type of situation. For instance, a World Bank survey focusing on African countries has observed that;

> *as government compensation falls, both in absolute terms and relative to alternative remunerative activities, civil servants adjust to the new situation. Turnover rates and absenteeism increase; moonlighting and delighting become more frequent, and the latter, more blatant; recruitment and retention, especially of professional become more difficult.*
>
> *It has also been argued that petty corruption rises including the sale of government services themselves, for example, under-the-table charges for livestock vaccinations or the extortion of payments by teachers to instruct school children (The Work Bank, 1994).*

The situation in Nigeria today is that productivity of civil servants has gone down to its lowest level. Absenteeism, lateness, strike actions and lack of interest and commitment to work have become the order of the day in most state civil services in the country.

CONCLUDING REMARKS

This paper has highlighted the significance of adequate and regular payment of salary or wages of employees in any organization be it private or public organizations. It has emphasized the importance of this particularly in the public sector as it affects civil servants in the civil services across the three levels of government in Nigeria. This is because the issue of adequate and regular payment of salary to civil servants has dominated the compensation scene in personnel management in developing countries of the world today. The paper also examined the negative impact of the turbulent economic situation in Nigeria on the adequacy and regularity of salary payment in recent years on civil servants. As a result of this situation, the salary or wage or civil servants across the country has been substantially eroded and compressed to the extent that many states and local governments now owe many months of salary to their employees with the proposal to even reduce workers salary of down-size the work force in the face of inflation and high cost of living.

The implications of this development for the performance and productivity of civil servants were also examined in this paper. Some of them include limited promotion prospects, institutional corruption, low level of employee motivation, laziness, absenteeism, lack of commitment to work, among others. Civil servants may also cut back their productivity or hours of work. They may also seek to change jobs to the private sector organizations as a way of searching for greener pastures. Overall, the inability of the civil services to pay a decent or living wage cannot attract and retain qualified, skilled and professional civil servants.

The disturbing aspect of these implication for the productivity and performances of civil servants is that it reduces the ability of the civil services to contribute meaningfully to the nation's socio-economic development and national development.

In the light of the above and in view of the fact that the performance of the civil services are critical to the effectiveness and efficiency of government services, it is suggested that, in order to make the civil services to contribute appropriately to national development, the issue of wage erosion and compression in the civil services must be checked immediately. Adequate and regular payment of salary must be a priority of every government at all levels in Nigeria.

It must be noted however that the proposal by the Governors' forum on the possible reduction of the N18, 000 minimum wages is untenable and cannot be enforced. This is because the minimum wage was not imposed on the Governors as claimed by them. It was actually negotiated through a tripartite system and legally adopted through a law of the National Assembly. This is contained in the second schedule section 4 Sub Section 34 of the 1999 constitution of the Federal Republic of Nigeria. In order to properly address the issue of paucity of fund as a result of fall in central government revenue, other sources of revenue must be explored to supplement the unstable and unreliable world oil prices. To this end, while it becomes imperative for the central government to diversify its economy, the states and local governments should also explore alternative sources of revenue. Such other sources are investment in Agriculture and solid minerals exploration. However, these sources may require fairly long gestation periods. For immediate generation of additional revenue, these governments should embark on aggressive internally generated revenue drive which has hitherto been largely ignored for a long time. This includes effective collection of all forms of taxes, rates, license fees among others. Board of Internal Revenue should be re-organized for more effective performance. It is also suggested that proper monitoring of revenue collection agencies must be ensured to check corruption on the part of revenue collectors. Accountability and probity must also be ensured by Chief Executives of governments at all levels. They should reduce drastically the cost of governance by cutting down on expenses of office in order to save more money for the welfare of the civil servants which is the core art of governance. They should reduce the number of political appointees who are not productive. This will reduce the danger of heavy reliance on the Federal government revenue allocation to other levels of government. Public financial management principles must be put into effective practice. When salary or wages of civil servants become regular an adequate, the major challenges to personnel management such as absenteeism, laziness, lack of motivation and commitment to work will be drastically reduced or eliminated. When this happens, the performances and productivity of civil servants will increase and be stable enough to make them play properly, their crucial role as the primary determinant of the nation's socio-economic development.

References

1. Anjorin, D. (1992) "*Compensation Scheme in the Public Sector*" in New Trends in Personnel Management: A book of Readings. Yahaya, A.D. and Akinyele, C.T. (ed) Administrative Staff College of Nigeria, Badagry, Lagos
2. Basu, R. (2012) *Public Administration. Concepts and Theories*. Sterling Publishers Ltd. New Delhi
3. Hays, S.W.; Reeves, T. Z. (1984) *Personnel Management in the Public Sector,* Allyn and Bacon, Inc. London
4. Kiragu, K. (2000) "*Civil Service Pay Reform Issues and Options in African Public Administration*. A Reader. Mukandala, R. (ed) AAPS Books, Harare, Zimbabwe.
5. Maduabum, C.P., (1998),: "*Wage/Salary Administration: A Sour-Point in Labour-Management Relations in Nigeria*" in African Administrative Studies No. 50
6. Okunneye, B. (1995) "*An Overview of the Nigerian Economic Environment*" Lecture presented at A.G. Leventis Senior Management Programme Mainland Hotel, Lagos cited in Madubum, C.P.
7. Olowu, D. (1991) "*The Environment of Nigerian Public Administration in a period of Uncertainty*. Sanda, A.O. (ed) Fact Finders International, Ibadan.
8. Olowu, D., and Adamolekun, L. (2005) "*Human Resources Management*" in Public Administration in Africa. Main Issues and Selected Country Studies. Adamolekun, L. (ed)
9. Omotosho, F. (2006) "*The Nigerian Civil Service: An Outsider's View*" in contemporary Issues in Public Administration. Omotosho, F. (ed) Bolabay Publications. Lagos
10. Stone, T.S. (1982), *Understanding Personnel Management* CBS College Publishing, New York
11. Tribune Newspaper, 21 November, 2015
12. World Bank Report 1994

IMPLICATIONS OF REGIONAL DEVELOPMENT ON LOCAL AUTONOMY

Anca GAVRILUȚĂ
Alexandru Ioan Cuza University of Iasi
Faculty of Economics and Business Administration
Iasi, Romania
gavriluta.anca@yahoo.com

***Abstract**: The problems that Romania faces due to the globalization process, imposes its necessity to manifest a large opening to all the cooperation forms. The demand for developing modern methods of organizing and running according to both central and local administration, on the other hand requires, the necessity of implementing some projects about the development and modernization of public administrations from Romania. By the fact that the unequal development of territories reflects the weakness of the entire (complete), and they are not acceptable because, at their turn, become sources of economic and political instability in the way of the harmonious development of the entire (complete), it is considered a deeper analysis of the regional development policies, respecting the considerations of the economic and social cohesion. Under the aegis of E.U. headline target achievement namely the regional development, we are still looking a solution to ensure a balanced distribution of the financial resources between the various levels of administrative organization considering the budgetary rigor that is required at all levels of public administration. The present work approaches the issue of regional development in Romania and its implications upon the local autonomy, I will use an analysis of the main economic indicators to emphasize the way in which the political objectives of the regional development up to the present, have been attained , as well as an elaboration of an analysis of local autonomy, considered to be the central pillar to achieve the objective of the regional development, considering the reasons of the degree of dependency of local authorities of the central ones, and the extent to which an emphasis on the phenomenon of local autonomy would be the ideal of Romania regarding the elimination of regional disparities. The paper is elaborated based on the empirical research on the theoretical scientific support using both statistical and comparison methods.*
***Keywords**: regional development, local autonomy economic and social cohesion, regional disparities.*

I. INTRODUCTION

The current image reveals us that the Romanian society is going through a process characterized by the notion of change; change which on account of adaptation attempts to the present conditions permitted the economical, social, political, civic sectors to acknowledge a new dynamic. In this aspect, it is imposed the necessity that our country to turn to advantage all the opportunities and to adapt its institutional capabilities by mobilization of the political class, applying the coordination of the levels of decision and respecting the civic society initiatives.

A tendency that is noted in the process of legislative and institutional reform in Romania is the influence that other's countries legislations and especially the international documents adopted by the Community structures have in terms of defining some concepts. Thus it arises the necessity that domestic law concepts to be adjusted to suit the concepts defined by the European conventions, in the context that Romania has already ratified some of this conventions and wants to integrate in the regional and transfrontier structures.

The regional development policy, we could say that is one of the most important and complex policies due to the fact that it is subject to some significant areas of activity for development, statute also pointed out by its objective that is reducing social and economic disparities between regions from European Union. Designed as a solidarity policy, the regional and development policy is mainly focused on financial solidarity, namely the redistribution of some part of the Community budget towards less wealthy regions and social groups. In conclusion the complexity of the regional development policy is illustrated by the fact that it has managed to incorporate three of the most important objectives of European Union which are economic and social cohesion, sustainable development and the principle of subsidiarity.

This study is focused on the regional development in Romania, first off all by presenting what progress has been made by our country in setting up a real success regarding the implementation of the regional development policies as well as pointing out clearly the level of economic development (GDP rate by region, total income rate and fiscality rate). Another aspect that this present paper deals with covers the implications of regional development on local autonomy, analyzing the interrelation between regional development and local autonomy, as well as the analyze of local autonomy seen as effect, consequence, necessity of regional development highlighting the its level, necesity of enhancing or controlling the process.

II. STUDY OF REGIONAL DEVELOPMENT IN ROMANIA

Although most of the theoreticians are interested in understanding the process of regional growth and decline, there isn't a general agreement on the definition of a region, many attempts has been made over the years in defining this notion, some of them simple and some of them more complex. An example of solid effort in defining the region as basis of foundation for regional development is the contribution of Christaller (1933), adopted later by Losch (1954). In central place theory of those two authors previously mentioned, the regions are defined as hierarchical systems of central places or cities. A more recent approach defines a region in terms of labor market force spatially or nodal interconnected. The concept of „functional economic area" of Karl Fox (Fox and Kumar 1994) represents a variation of the concept of nodal region, which has the ground idea that domination of a nodal center over a surrounding area can be assigned to the special dependency of workers to the adjacent employment centers.

Regions can also be defined in terms of natural resources, ecosystems or other geographical boundaries. Some authors define the region as the interdependency between natural resources and human population systems (Pușcașu Violeta, 2000, p. 45).

Regional development is a concept closely related derived from the general concept of economic development. More accurate, the concept of regional development is based on territorial aspects in spatial distribution terms of economic development.

It was not until 1997 when the concept of regional development achieved an actual meaning in Romania, when in the context of joining to the European Union was published “The Green Paper. The regional development policy in Romania“. In this document, besides the political objectives strictly related to European Union adheration was also defined the objective of regional development in Romania, respectively the reduction of disparities between the regions of Romania and also their growth of the level of development in order to reduce the discrepancies between Romania and the other member states of European Union.

During February 1996-31 January 1998 The Government of Romania set the objective to establish within a Program for Regional Development Policy the editing of a set of fundamental and essential principles for the development of a regional policy in Romania, published in Green Paper. Actually The Green Paper represents a synthesis that aims to set the basis of some principles for Romania’s regional development in order to achieve the integration to the European Union.

An approach of the development regions of Romania has been made in the previous sentences but to clarify this concepts we need to present the development regions of Romania in terms of economic development level that points out to what degree we need to enhance the decentralization process from our country and to what degree we can really discuss about regional development.

In order to elaborate the most accurate analyses of development regions of Romania and also to bring out a much wider situation of Romania’s economic cohesion and regional disparities we need to look in to the structures of local budget income to measure the quantum of income from every county and also from every region. Certainly, due to the policy of decentralization that Romania has applied in the past years, the income of local budgets are provided from their own revenues (around 40 %), loans and also revenues deducted from the state budget.

In the conditions that fiscal pressure or the level of fiscal pressure reflects the level of submission of taxpayers that are bearing the burden of facility and on the other hand it indicates to what degree the public expenses can be funded, the level of fiscal pressure can generate both economic and social effects. In this context it is useful to point out the level of fiscal pressure at regional level as well as the rate of GDP in order to determine to what degree the respective region is affected or not from an economic point of view and also to detect both intra-regional and inter-regional disequilibrium’s (table 2).

Based on the data provided by the National Statistics Institute we have exemplified an evolution (table 1) of GDP for the interval 2004-2011, presenting the GDP by country and by the level of each region.

Table 1 GDP values by development regions of Romania (Ron/inhabitant)

	2005	2006	2007	2008	2009	2010	2011
Total by country	13362,8	15967,6	19315,4	23934,6	23341,4	24435,9	25123.5
North – East Region	8907,6	10295,8	12340,9	14794,5	14649,3	15014,8	14912,9
South –East Region	11541,7	13569,8	15641,8	19098,9	18738,2	20076,8	21223,4
Muntenia Region	11068,5	13374,6	15757,8	19648,1	19913,7	20288,2	21178,5
South -West Oltenia Region	10371,1	12463,2	15097,3	17831,8	17752,8	18735,1	19023,9
West Region	15064,7	18570,1	22341,9	26173,2	25602,4	27640,0	26490,6
North – West Region	12538,6	14946,6	18610,5	21542,1	21297,4	21827,2	21644,8
Center Region	13097,6	15920,2	19579,5	22707,7	22618,8	23428,3	23778,5
Bucharest – Ilfov Region	29572,6	35012,1	43037,3	59680,2	55079,3	58137,0	60647,8

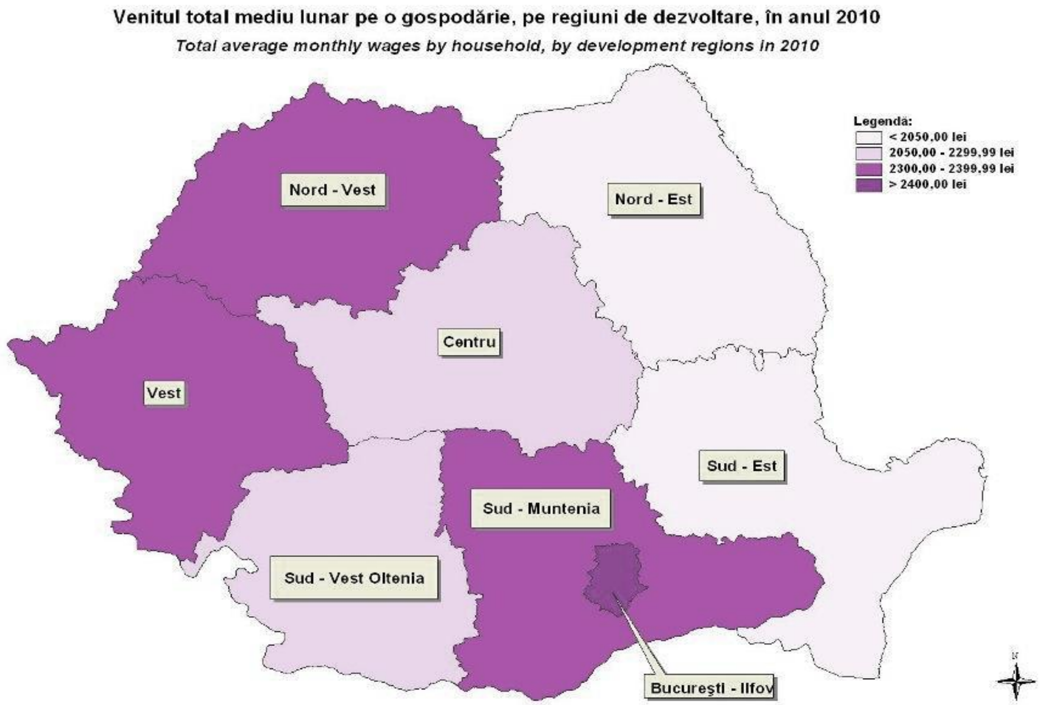
Source: computed by author using data from www.insse.ro

Economic development is usually expressed by GDP, an indicator that can be used in regional context to measure the activity and macroeconomic growth and also it provides us a comparation method between regions.

The specialty literature illustrates the principle of regional equity and sustainability, principle that starts from the premises that from realistic point of view the resources and in general welfare is uneven distributed on the national territory (Oprea, 2013, p.48). In this way the natural resources concentrated especially in some regions of the country, fact that is obviously presented in table 2, where we can notice a disequilibrium concerning the GDP value between regions. In the conditions that the GDP value reflects the quality of life and also the level of economic development of each region, it is obviously that the standard of living is significant different from one region to another. We can notice that the North-East region is the poorest region from Romania in this five years that we studied, with a value of GDP in 2011 of 14912,9 Ron, while Bucharest-Ilfov region registered an ascendant trend of GDP in 2011 with a value of 60647,8 Ron.

We could say this situation is absolutely normal and this values only reflects a reality that in fact, it should be as it is, on the premises that is normal that some regions to be more wealthy but the problem that comes to our attention are the inequalities that are being manifested especially within the same region, problem that we will discuss later for the period between 2010-2011, when we will exemplify the total fiscal income as well as the value of GDP at the level of each region.

Figure 1 Total monthly average wages by development regions household in 2010



Source: www.insse.ro

In figure 1 we can determine from this map of Romania the total monthly wages per household by development regions. We can notice that the South-East region registered the smallest amount of values with a quantum of total income per month by household less than 2050 Ron while Bucharest-Ilfov region registered a total bigger then 2400,00 Ron. Regions Center and South-West Oltenia are close to regions North-East and South-East but only from a geographical point of view and as far as concerns the GDP values these regions registered values of the total monthly income per household between 2300,00 and 2399,99.

In the table three we applied an analysis of fiscal pressure at both level of county and level of regions, on the idea that I mentioned earlier, more precisely to measure in what level of degree the respective region is being or not affected from the economic point of view but also to capture the disparities that we are facing both intra-regional and inter-regional.

Table 2 The Fiscal pressure at county level and regional level In Romania (2010 and 2011)

mil. lei	Anul 2010				Anul 2011		
Macroregiunea Regiunea de dezvoltare	Venituri fiscale	PIB	Presiune fiscală		Venituri fiscale	PIB	Presiune fiscală

Judeţul	totale		totală		totale		totală
TOTAL	37346	514700	7.26%		36731.6	501139.4	7.33%
MACROREGIUNEA 1	8986.337	115941.8	7.75%		8766.331	115001.1	7.62%
Nord - Vest	4569.522	58638.8	7.79%		4436.458	57900.2	7.66%
Centru	4416.814	57303	7.71%		4329.873	57100.9	7.58%
MACROREGIUNEA 2	9673.438	108873	8.89%		9423.474	107114.4	8.80%
Nord - Est	5262.616	55021.9	9.56%		5100.859	54408.4	9.38%
Bacău	1025.217	11972.1	8.56%		932.2544	11784.8	7.91%
Botoşani	595.7679	5556.7	10.72%		594.6951	5530	10.75%
Iaşi	1192.221	15058	7.92%		1203.146	14806.3	8.13%
Neamţ	751.3009	7613.2	9.87%		724.4867	7403.2	9.79%
Suceava	1007.841	9765.4	10.32%		1021.033	10066.6	10.14%
Vaslui	690.269	5056.5	13.65%		625.2442	4817.5	12.98%
Sud - Est	4410.822	53851.1	8.19%		4322.616	52706	8.20%
MACROREGIUNEA 3	11840.12	198698	5.96%		11837.78	189430.6	6.25%
Sud - Muntenia	4915.513	64535.4	7.62%		4700.007	65141.8	7.22%
Bucureşti - Ilfov	6924.603	134162.6	5.16%		7137.776	124288.8	5.74%
Ilfov	786.4821	13145.8	5.98%		777.9054	12913.9	6.02%
Bucureşti	6138.121	121016.8	5.07%		6359.87	111374.9	5.71%
MACROREGIUNEA 4	6846.109	90733.6	7.55%		6704.012	89154	7.52%
Sud - Vest Oltenia	3486.44	40340.2	8.64%		3358.546	39953.8	8.41%
Vest	3359.669	50393.4	6.67%		3345.466	49200.2	6.80%

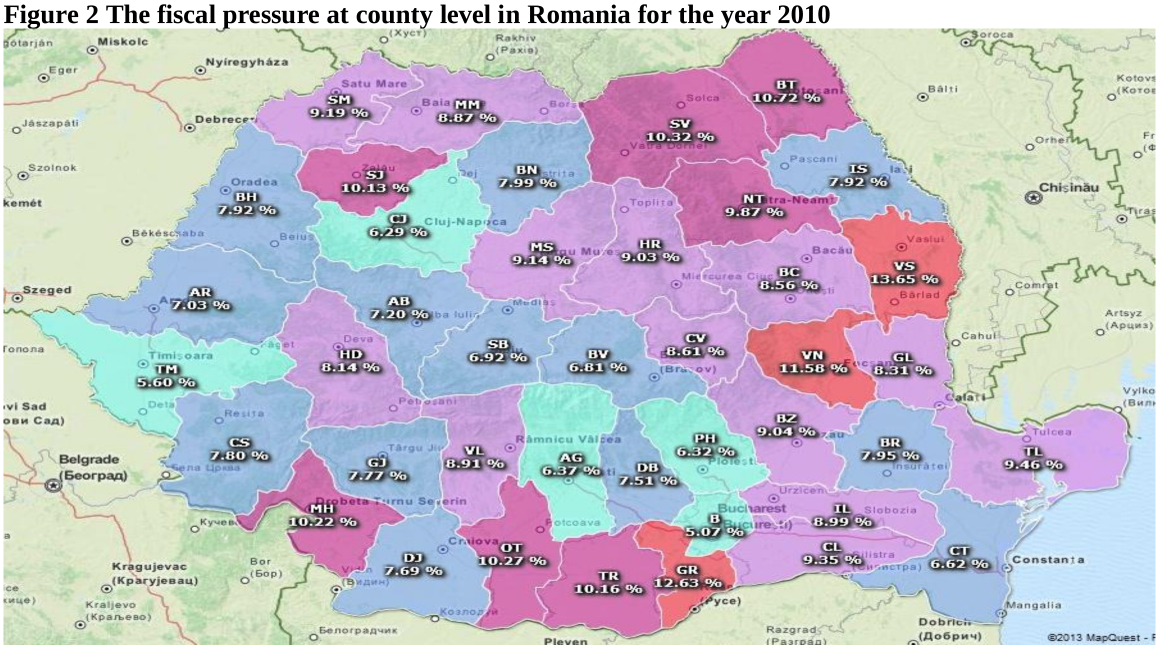
Source: computed by author using data from Țibulca Ioana, Doctorate thesis, Bucharest Academy of economical studies, fiscal pression, and fiscal convergence

The level of own income (fiscal income) considered by reporting them to the number of inhabitants or as percentage from the total income, gives us important informations about the level of economic and social development of local collectivities (Oprea, Cigu, 2013 p.198). It also brings to our attention the financial subordination of local collectivities by the central collectivities. In this context, according to the datas provided earlier (table 2), we notice a disequilibrium regarding the intra-regional and inter-regional fiscality, fact that raises the question- In what degree the local collectivities have financier autonomy and in what degree Romania would need to intensify the process of decentralization ?

The answer in this situation comes from the interconnection of regional development with local autonomy, interconnection that points out that by organization of regional structure it could be possible to turn to profit the local resources and also to turn to profit the characteristics of territorial administrative units.

In order to be more precise, we present a cartographic representation of the fiscal pressure data from Romania, (figure 2 for the year 2010 and figure 3 for the year 2011), for the year 2010 (fig 3) Romanian counties are divided in five levels, according with the rate of total rate of income. In this way the counties that registered very low fiscal pressure (5%-6%) are represented on the map with the light blue color and it includes the counties Cluj, Timiş, Prahova, Argeş, împreună cu Municipiul Bucureşti. The second level is represented by the counties with low fiscal pressure (6,5 %-8 %) and includes 13 counties, most of them being from Transilvania: Brașov, Sibiu, Alba, Arad, Bihor as well as county that incorporate some of the largest cities from Romania: Iasi, Dolj and Constanta

Figure 2 The fiscal pressure at county level in Romania for the year 2010



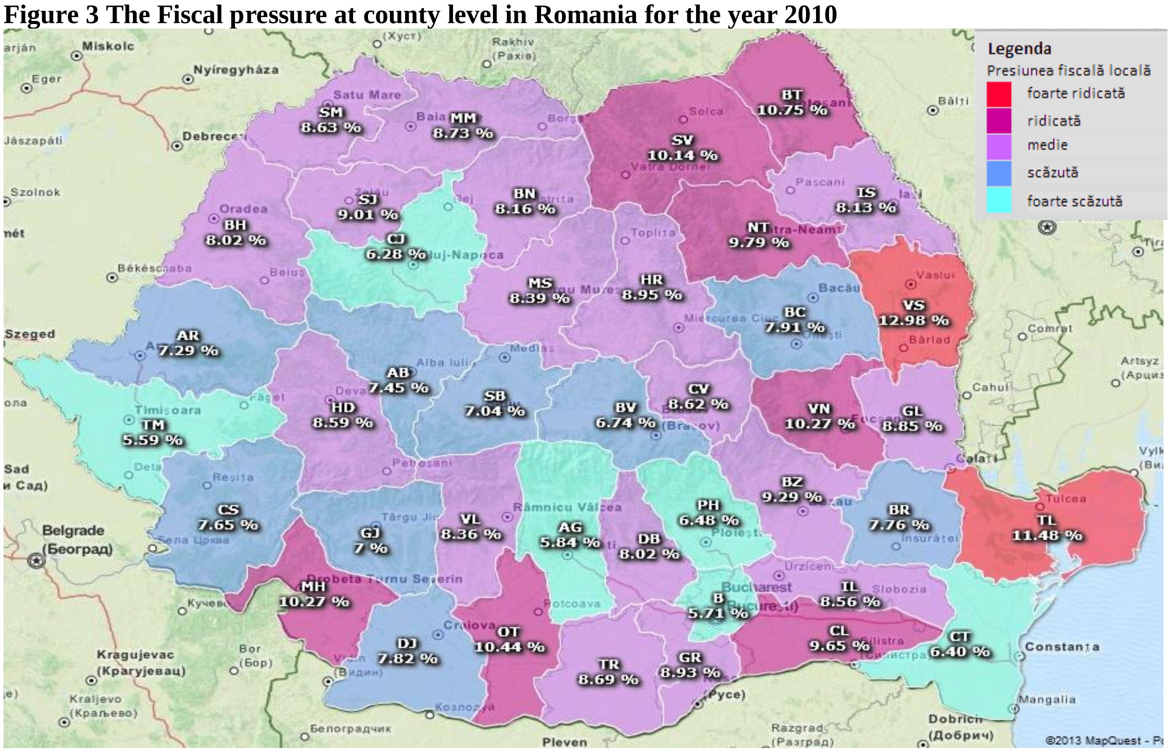
Source: computed by author using data from table 2

The third level registered a medium fiscal pressure (8%-9,5%), and includes 13 counties: Bacău, Tulcea, Covasna, Harghita, Satu Mare etc. The fourth level registered a high fiscal pressure (9,5%-11 %) and includes areas from North-East development region (Suceava, Botosani, Neamt), but also areas from South-West region (Teleorman, Olt, Mehedinti). The last interval incorporates three counties: Vaslui, Vrancea, Giurgiu and registered very high values of fiscal pressure (11%-14 %)

Therefore if we would elaborate a hierarchy based on the level of fiscal pressure for the 2010 year it is obviously that the County of Vaslui is on the top of the list with the highest value of fiscal pressure (12,62 %) and to the opposite direction is situated the Municipality of Bucharest (5.07 %).

In figure 3 it is presented the fiscal pressure at county levels of Romania in 2011 that have also been divided in 5 levels like in the previous situation, with the same colours representation and meaning but with different intervals of fiscal pressure that are representative for the year of survey 2011.

Figure 3 The Fiscal pressure at county level in Romania for the year 2010



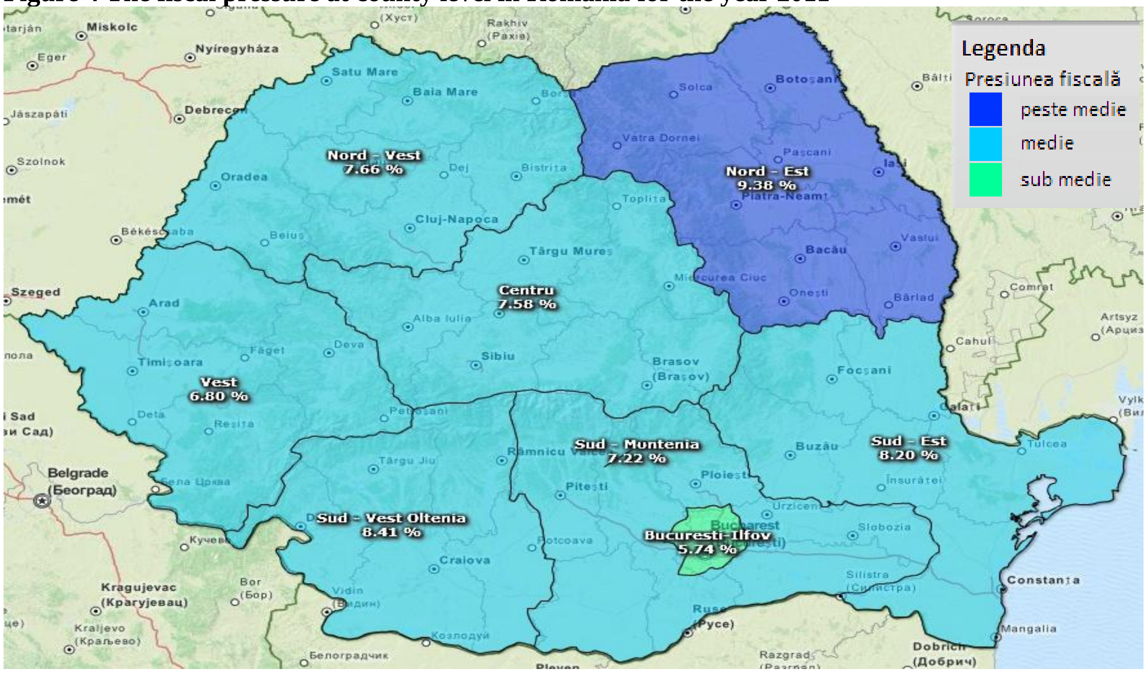
Source: computed by author using data from table 2

We can see that there is a decreasing of fiscal pressure for the tax payers from County of Constanta and as a result it switched from the first level to the second one. In the areas of Dambovita and Bihor in 2011 there has been a growth of the fiscal pressure that determined them to switch from second level to the third one with a medium fiscality.

In this year of survey the level with medium fiscality incorporates the vast majority of the counties, and it has also been pointed out that the County of Vrancea registered a diminution of the fiscal pressure in 2011 compared with 2010, therefore it has switched from the category of counties with a very high fiscality to high fiscality.

From the point of view of a hierarchization of the fiscal pressure we notice again the County of Vaslui in the last place. The smallest rate of fiscal pressure is registered by Timis (5,59) followed by Bucharest (5,71 %).

Figure 4 The fiscal pressure at county level in Romania for the year 2011



Source: computed by author using data from table 2

III. LOCAL AUTONOMY - DIRECT CONSEQUENCE OF REGIONAL DEVELOPMENT

As a consequence of the fact that the nowadays society is situated in the phase of finding ideal solutions to ensure a real social and economic development in Romania , we must consider to intensify the decentralization principles and local autonomy, of course that local, takes an important role in creating the regional development policies, because if it is analyzed from an administrative and financial point of view, it can help to create the basis of financial decisions in the context of financial management of the process of local collectivities. It must be mentioned that just a simple acceleration of the process of local autonomy well lead most likely to an intensification regional disparities already established and it would create a bigger instability in terms of economic and social of the country. On this topic it is necessary to deal in this present paper the direct threats that the regional development can bear upon on the local autonomies, highlighting the main conditions regarding both insurance and finding proper solutions for improvement of local financial autonomies.

Table 3 The evolution of local autonomy degree and the capacity local financing colectivities during 2004-2010

Indicator/Year (%)		2004	2006	2008	2010	2011
Total Income		15,956	27,709	43,629	48,254	49,245

Total expenditures	15,541	25,393	42,210	51,451	52,786
Own revenues	9,710	12,152	20,588	22,456	23,654
Financial autonomy degree	60,85	43,86	47,19	53,18	53,68
Self-financing capacity	62,48	47,86	48,77	49,51	50,13

Source: Statistic Yearbook

Local collectivities must be able to complete their obligations that they have as public institutions without being obstructed by financial coercion that cannot be impeached to them. Therefore, any transfer of responsibilities from state local collectivities must be accompanied by the equivalent and concomitant transfer of financial resources (Onofrei 2007, p.59). In this way this transfer of resources must correspond to the real price of the newest transfer of competence. Collectivities must have sufficient power for manoeuvre a real financial autonomy for these expenditures, which becomes the real goal of a successful decentralization and of social and economic equilibrium (Alina Profiroiu, Marius Profiroiu, 2007 p.28). We must mention that a significant increasing of this process without an equilibrate strategy well organized would rather lead to an enhancing of the existent disparities between the wealthy and poor collectivities from the same region, and the poor regions might not be able to ensure not even a minimum of decentralized services.

As a result of the facts that we have presented and analyzed, we can observe discrepancies between both inter-regions and intra-regions of Romania, because all the eight regions of Romania has some particularities that have direct impact on their economic structures and some of this particularities were allowed to play an essential part their future development. Under these circumstances the agriculture sector is the main catalytic of economy in the regions from the south of the country. This sector has a percentage bigger than 15%, fact that makes the GDP of these areas vulnerable in the years when the climate conditions for agriculture are unfavorable. In other order of ideas we have some areas with high touristic potential like Bucovina from the North-East Region or the coastal line of the Black Sea and Danube Delta, both situated in the South-East Region, obviously this economic development is given by the potential that this regions own and more especially how willing and capable are these regions to turn to profit their potential. Another particularity are the areas where the extractive industry played an essential part in the economy. The most relevant example in this case is the decline of the economy from the area of Jiu valley situated in the South-West region caused by the restructuring of the mining sector.

Therefore it imposes the necessity of implementing a local autonomy process with direct impact on the growth of the budgetary level by taking into consideration the own fiscal effort as well as the implementations as some new mechanisms, tools and also contractual procedures between state and local collectivities or between the local collectivities that have as purpose to implement concrete methods over the financial actions and even on financial methods and maybe the development of some solidarity between the local collectivities. On the other hand it would be also useful the implementation of some mechanisms that would give multiannual guarantees of transfers offered by the state within the purpose of this transfers to grow progressively with the rate of inflation and economical rate of growth, fact that would allow the local collectivities to be able to be protected by the imprevisibility of some of the actions and decisions made by the State.

IV. A PROACTIVE APPROACH OF THE REGIONAL DEVELOPMENT STRATEGY

After previous exemplifications we can affirm that our country is still situated in the search of a ideal formula to a repartization of the financial resources as balanced as possible, the analysis that has been made presented the fact we are facing with severe economical disequilibrium both between the regions but more often within the areas of the same region that causes a differenced standard of life, that represent for Romania sources for economical and political instability that stands in the way of coherent development of the whole entity because an unequal development of the territories reflects weaknesses of the whole entity (area, region, state etc.). It is useful to mention that a model of regional development that should tend to a maximum successful outcome would be the one that would be founded on the principles of decentralization and local autonomy and basically to decentralize would imply to grant administrative autonomy to the local authorities.

On the background of the previous idea we can draw the conclusion that the solution, modality hereby our country would get to the highest level of economical and social cohesion and we could really discuss about an effective policy of regional development would need to rely on the concepts of this two processes. Of course that the theoretical basis is very well implemented and the literature of speciality presents very detailed that are the fundament for the public administration in Romania that indicates a leading role of this principles among the European countries (Poland, Lithuania, Estonia etc.), countries that managed to successfully apply this methods and they made some amazing performances. The situation of Romania requires a different approach because it is not absolutely necessary that what was successful for other can also represent a viable solution for our country.

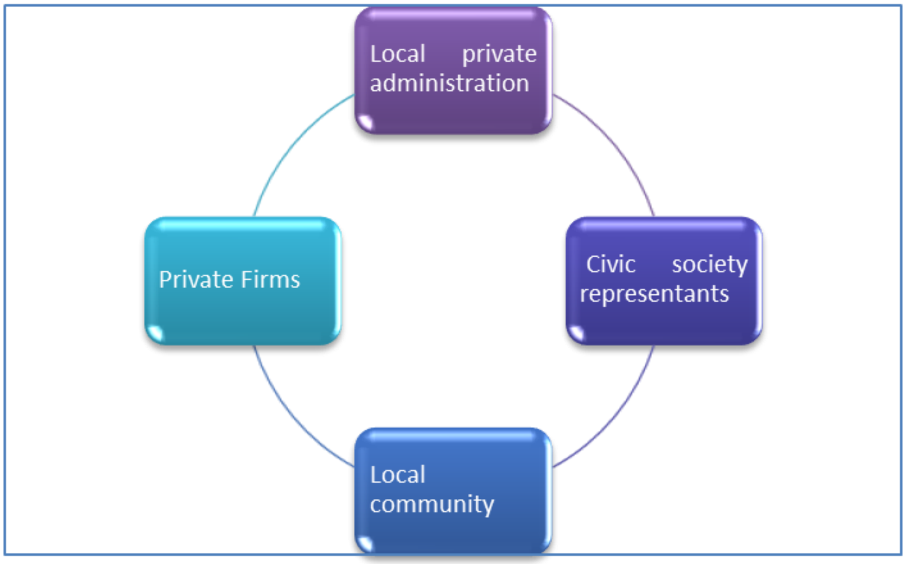
As a result of the previously ideas presented in this paper it is more than obvious that the local autonomy in general and financial autonomy can be joined by the existent differences between the poor and wealthy collectives from different regions or even from areas of the same region, that could make impossible for poor local collectives to ensure at least a minimum of decentralized vital services.

From this point of view the analysis performed until now needs a completion, bringing in discussion the elements or potential strategies that should be applied, making an appeal to a primordial mechanism and more specific equilibrium, with the objective to restribute the welfare and reducing the disparities between the local collectivities.

Any development strategy needs to have in consideration an active coordination of the development processes that take place in territory, by also considering the changes that could emerge from the exterior, it is necessary that beside the orientation to change, towards a sustainable profit also shaping a concept, image for the future. A strategy for development not only reacts to changes , taking in consideration the elements of different internal or external factors but it has in its structure also proactive elements by making different additional plans that could be applied if the change of situation would require this.

In a first order of ideas, a development strategy must respect the sustentation the partnership between the actors presented in figure 5.

Figure 5 Actors involved in the process of creation and implementation of local development strategies

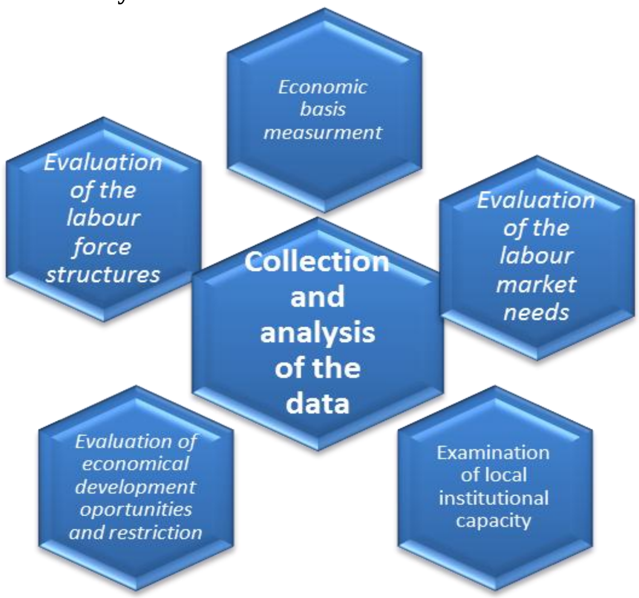


Source: computed by authors

We can observe from figure 5 an example of the actors that are involved in the creation and implementation of local development strategies, actors that are vitals in the process of a successful implementation. A primordial importance it has the local public administration which is active both in creation and also in implementation of the local development initiatives. Of course that also the others actors involved in the process of creation and implementation of strategies of regional development are very important and their contribution is valued the same as the local public administration, because, in order to create an equilibrated atmosphere from the beginning of the process of creation and judging proactive the contribution of each actor involved we set the grounds of a future regional development with a direct impact on elimination of economical disequilibrium and of existent disparities that are present at this time in Romania.

From the moment that we speak about a regional development strategy it is necessary to take to account a first introductive stage structured in two parts: a part that captures the presentation of most important European and national development strategies and another part that should integrate the territorial administrative units in the geographical-historical space (Balogh Morton, 2003, pag.76).

Figure 6 Collection and analysis of the data



Source: computed by authors
Figure 6 Exemplification of the most important indictors from first phase, analyzing and collecting of data

The second step that must be followed in order to consolidate a development strategy is the diagnosis and analysis of statistical indicator from the region, micro-region, and the area of development.

During this step, the collecting of data has a significant importance for the entire process of creation of the local private administration. From this perspective, it is useful an approach on two levels regarding the collecting of data directly from the beneficiaries and also from the official statistics sources (Georgescu, p.123)

The vast majority of data is being collected directly from the beneficiaries of the strategies of development, being extremely important that the future beneficiaries to offer their support needed for an accurate collecting and to fill in the forms the locality and the area where the collecting of data has been made.

The second nivel, requires a system of collecting and analysis of data using official statistical sources.

As a final operation we must apply the collecting of data from both levels in order to create an accurate data base regarding the locality, the area that was studied. Besides the step of data collecting we must also to capture the community's abilities to administrate or to initiate local development projects.

Table 4 Most important indicators that are subject to analysis and diagnosis

Area	Standard / Indicators
Phisico-Geographic	Forms of relief Geographic location Natural risc factors Protected natural areas

Population	Number of population Density The evolution of population Growth factors of population
Householdings	The endowment of houses with water and gas facilities The uzure of houses Construction materials
Economic	Agricol potential Forestier potential Touristic potential Industrial potenţial The structure of agricol proprieties The level of labour enforcement occupation
Urbanistic Infrastructure Of the localities	Electric energy endowment Natural gas endowment Racordarea la reţele telefonice Acces to transport comunications
Socials	Health Education Comunications Infantil death
Enviroment/ Ecology	Air Water Soil Forests

Source: *computed by authors*

If we talk about areas previously mentioned, we also need to present the initiative in obtaining unreimbursable financing, and also the mentioning of some feasibility studies or other similar studies, useful in the process of documentation and later in the elaboration of the development strategies.

Later, in the context of the exemplified data on the data base that is already created, it is useful to create a SWOT analysis, in order to elaborate the development plan. The SWOT analysis is important due to the fact that it is able to capture both internal and external factors, the influences of external environment, taking to account both positives and negatives factors. The necessity of the present paper is given by the motivation of a complex representation of reality given by analyzing the internal particularities of entities which the strategy is based on, the strengths and the weaknesses and then by analyzing the external influences, the positive ones are called opportunities and the negatives one are called threats.

Also in this stage can be included other papers promoted by us in the process of creating the development strategies, more precisely a chapter named by us The Analysis an monitoring the local development agencies. By development agents we understand institutions of the local public administration, non-governmental organizations, privates entrepreneurs, citizen initiative groups, institutions like church, school etc. The role of these agents in the stimulation of the local development processes is very important, because they are, mostly in the rural areas, the agents that have the biggest influence on the process of regional development. The technique used by us to measure the level of implication of these agencies in the local development is realized with the help of sociologic investigation. The fact that draws our attention in this case is not just the implication of agents previously mentioned in development of the local communities in which they live but also the image that this agents have in their provenience communities.

Phase II The establishment of the local development strategies

In this stage we include to essential elements that we use in elaborating the strategies of development, respectively the strategic objectives of development (the mentioning of methodology and local developments agents involved in the process of creation of the development strategies, as well as the identification of some strategic areas of development) and operational objectives (the development program must be thinked and built as a system that aims the regional development).

Figure 7 The first steps for established the strategy of local development

Source: Own Processing

Phase III The selection of local development projects

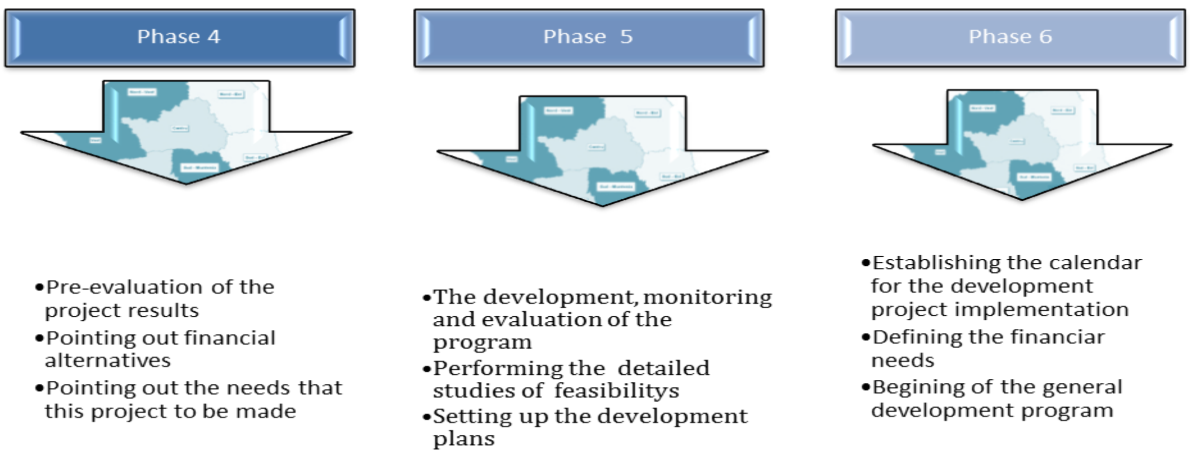
In this stage the development programs and projects that are being used in the development strategy are being presented. They are divided by many factors: according to what degree of the implication of the developments agencies, the period of time that is needed for implementing. In this stage we refer to:

- The identification of the possible development project
- Evaluation of the viable projects (from the point of view of community, location, commercial and implementation)

In this stage it imposes a close collaboration between the group that elaborates the strategic plan and the public administrative institutions (PAI). This type of collaboration has a double motivation:

- The group of experts has a certain vision of the policies of financing for the project of communitarian or local development

The institutions of public administration know the best the local resources (financier and non-financier) that can often be inserted in some development projects).



Source: Own Processing

In previous exemplification we have pointed out both the steps of the steps that must be followed to obtain strategical planification, this being the duties of the persons that elaborates the strategic development plan (phases 1,2,3) as well as the steps that are responsible for implementation (4,5,6). It must be mentioned the fact that besides the development agents it is imposed the necessity of consulting some specialists in the areas of expertise that have connections with the regional development. Their contribution must be mainly focused in expertise of the technical and financial nature details.

The strict following of the steps previously mentioned, together with an efficient process of local economy characterized by the constitution of some stabilization coordinates and financial equilibration, represents the ideal solution for our country in the perspective of implementation of a regional development that have a direct impact in elimination the economical and financial disparities.

IV CONCLUSIONS AND SUGGESTIONS

In the process of achievement of regional reform, the main objective of EU, we are still searching a solution to ensure a repartition as balanced as possible of the financial resources between the different levels of administrative organization, being aware of the budgetary rigour is imposed at all levels of public administration.

The analysis effectuated reveals that the natural resources are concentrated more often in just some regions of the state, fact obviously illustrated in the table 2, where is presented a disequilibrium in terms of the value of GDP per region. In the conditions that the value GDP reflects the quality of life and the level of economical development of each region, it is obviously that the standard of life is significant different from a region to another, we can notice that the South-West region is the poorest from Romania in all 5 years that has been subject to this study, with a GDP value in 2011 of 14912,9 Ron, while the Region Bucharest-Ilfov registered in 2011 a GDP value of 60647,8.

We could say this situation is absolutely normal and this values only reflects a reality that in fact, it should be as it is, on the premises that is normal that some regions to be more wealthy but the problem that comes to our attention are the inequalities that are being manifested especially within the same region, but analyzing their own incomes (fiscal incomes), considered by reporting them with the number of inhabitants or as a percentage from the total income, we discovered information about the level of economic and social development of the local collectivities pointing out major discrepancies and also a financial dependency between local and central collectivities. Analyzing the monthly average income per household at the level of development regions we can see that the South-East region registered the smallest amount, less than 2050 Ron, while region Bucharest-Ilfov registered an amount bigger than 2400,00 Ron. Close to the regions North-East and South-East but only from a geographical point of view but not also from the point of view of the income registered are situated the regions Center and South-West Oltenia with values between 2050 and 2299,99 Ron. Regions North-West, West and South-Muntenia registered values of total monthly average income per household between 23000 Ron and 2399,99 Ron. From the point of view of a hierarchization of the fiscal pressure from 2011 we notice again the County of Vaslui in the last place. The smallest rate of fiscal pressure is registered by Timis (5,59) followed by Bucharest (5,71 %)

As an answer to the question: To what degree the local collectivities have financial autonomy and in what degree Romania would need an intensification of the decentralization process?, is more than obviously that the local collectivities must be able to complete their obligations that they have as public institutions without being obstructed by financial coercion that cannot be impeached to them. Therefore every transfer of responsibilities from state to local collectivities must correspond with the equivalent and concomitant transfer of financial resources. So this transfer of resources must correspond with the real charge of the competences transferred. In this way the collectivities will benefit by a sufficient room for maneuver thus a real financial autonomy for these expenses which becomes the essential objective for a successful decentralization as well as for social and economic equilibrium. I must mention that an acceleration of this process without the foundation of a balancing strategy well organized would rather lead to an enhancing of the existent disparities between the wealthy and poor collectivities within the same regions, and the poor regions might not be able to ensure not even a minimum of decentralized services.

From the recommendations point of view we could underline first of all the necessity of implementing a local autonomy process with direct impact on the budgetary equilibrium growth by taking into consideration the own fiscal effort as well as the implementation some new mechanisms, tools and contractual procedures between state and local collectivities or between the local collectivities in order to implement concerted methods over the financial actions and even to the financial methods and maybe to developed some solidarity between the local collectivities. On the other hand it would be useful to implement in the transfers granted by state some pluriannual guarantee mechanisms in order to ensure that this transfers will grow progressively with the rate of inflation and economical rate of growth that would allow the local collectivities to protect themselves from the imprevisibility of some actions and decisions made by state. Another recommendation is the importance of following the phases of regional development strategies both the phases responsible for the strategical planification (phases 1,2,3) that were created by those responsible for the elaboration of the strategical development plan as well as following the phases that are responsible for implementation (phases 4,5,6). We can also add the importance of development of parteneriaships, the development of an integrated system of information management as well the consolidation of the role and position of regional development agents. As a responsibly approach of the field we must be concerned with elements regarding the standard of living, training the human resources involved, a genuine educational process that would really represents a long term investition for a successful regional development strategy but also for all the policies and strategies that aim the attainment of social and economic cohesion.

References

1. Alina Profiroiu, Marius Profiroiu, *Autonomia Financiară a colectivităţilor locale-premisă a succesului descentralizării*, 2007.
2. August Losch, *The Economics of Location*, 1954.
3. Florin Oprea, Elena Cigu, *Finanţe publice locale*, Editura C.H. Beck 2013.
4. Florin Oprea, *Managementul financiar al colectivităţilor locale,* Bucureşti, 2013, Tritonic Books.
5. Carta Comunitară a Regionalizării, Document elaborat de Parlamentul European în 18 noiembrie1988 şi adoptat ca document oficial al comunităţii Europene la 19 decembrie 1988.
6. Georgescu Maria-Andrada, *Management financiar public local,* editura Pro Universitaria, Bucureşti, 2010.
7. Hotărârea nr. 699/2004 pentru aprobarea strategiei actualizate a Guvernului privind accelerarea reformei în administraţia publică, 2002-2004.
8. Legea-cadru nr. 195 din 22 mai 2006 a descentralizarii, M.O. 453 din 25 mai 2006.

9. Matei. C. Matei, A.- *Acquis comunitar şi administraţie publică*, Editura Economică, Bucureşti, 2009.
10. Mihaela Onofrei , *'Fundamente stiintifice si bune practici'', Editura Univesitatii* ''Alexandru Ioan Cuza'', Iasi, 2007.
11. Petru Filip, *Managementul administraţiei publice locale,* Editura Economica, Bucureşti, 2007.
12. Profiroiu, M., *Managementul strategic al colectivităţilor locale*, Editura Economică, Bucureşti, 1998.
13. Puşcaşu Violeta, *Dezvoltarea regională*, Bucureşti, 2000.
14. Țibulca Ioana-Laura, Lucrare de doctorat, Academia de studii Economice din Bucureşti, *Presiune fiscală- convergenţă fiscală şi impactul asupra încrederii în mediul de afaceri în context international, Bucureşti, 2013.*
15. Vadineanu, A., *Dezvoltare Durabilă. Teorie şi Practică*, Vol. 1, Editura Universităţii din Bucureşti,1998.
16. http://europa.eu.int/comm/regional_policy/ns_fr.htm.
17. www. ec.europa.eu/regional.
18. www.insse.ro.

THE BUDGET SUPPORT OF THE WAGES IN THE PUBLIC SECTOR

Ioan HURJUI
„Stefan cel Mare" University of Suceava, Romania,
Faculty of Economics and Public Administration

Alunica MORARIU*
„Stefan cel Mare" University of Suceava, Romania,
Faculty of Economics and Public Administration
alunica.morariu@gmail.com

Nina HOLBAN
„Stefan cel Mare" University of Suceava, Romania,
Faculty of Economics and Public Administration

***Abstract**: This paper starts from the observation that the share of staff costs included in the consolidated general budget increased considerably in the past two years. The explanation was the reunification of budget salaries and the payment of overdue obligations established by court decisions. Here we insist on several issues concerning the relationship between public policy of wages and policies / strategies of public finances in the context of current economic parameters (years 2014 and 2015), taking into account the latest acts making changes in minimum wage, increases of pension and social security etc. An important part of our approach is meant to reveal changes occurring in the structure of budgetary expenditures as a result of wage policy and social safety nets in Romania.*
***Keywords**: salaries, financial crisis, public budget, wage policy/ strategy, laws/ rules, social measures.*

1. INTRODUCTION

The link between policy of wages in the public sector and wage policies/ strategies of public finances is a subject of debate in many papers in the economy field. Obviously, the salary and remuneration presents interest to be analyzed from multiple points of view - management, accounting, audit, labor law etc. (Piketty, 2014; Chişu, 2002; Bârcă, 2005; Bostan, 2010; Bostan & Radu, 2003; Tofan & Petrișor, 2012; Tinică *et al*., 2010), but we here dwell on this theme only in relation to public budget resources/ expenditure. What is recognized widely is that without economic resources available to the state, mobilized overwhelmingly through taxes, public sector remains in obvious suffering (Florişteanu, 2014; Morariu, 2015a, 2015b; Măţăuan, 2014; Bostan, 1999; Oprea & Petrișor, 2011). After passing the peak of the financial crisis (caused by inadequate policies, which led to the deterioration of macroeconomic balances, making in 2009 for the economic growth to be of -7.1% compared to + 8.5% of the previous year), it can be said that the Romanian economy entered into a significant phase of recovery - more pronounced starting from 2012 (Fig. 1).

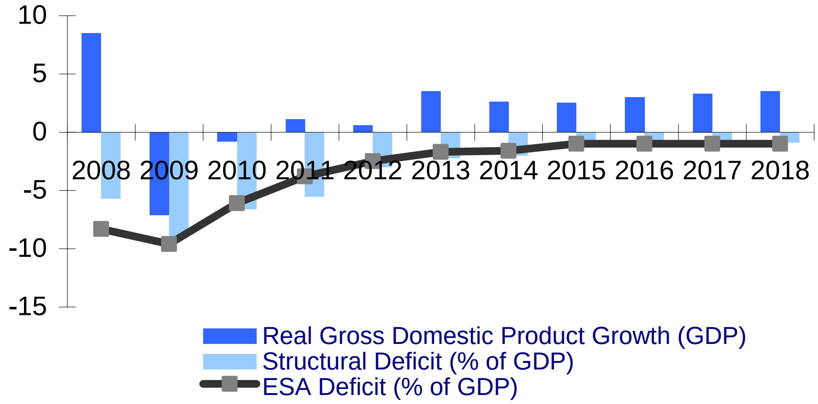


Fig.1 The evolution of economic growth and budget deficits in the 2008-2014 periods
[Source: GR/MFP, 2014]

The grounds of sound public finances, given in the macroeconomic situation report for 2015 (...), developed by MFP are given by the existence of a greater confidence of investor, fiscal discipline and reduction of waste, being recorded progress on the line of achieving the right balance between fiscal consolidation and sustainable economic recovery, ensuring credibility and predictability of economic policy and financing the budget deficit at a reasonable cost.

The analysis of achieving the objectives of fiscal policy in the period 2013-2014, reflects (Romanian Government, Ministry of Finance, Report on the macroeconomic situation in 2015 and its projection for the years 2016 to 2018) that the budget deficit calculated according to the European methodology decreased from 5.5% in 2011, to 3% of GDP in 2012 and 2.2% of GDP in 2013, Romania getting out from the excessive deficit procedure of the European Union. For comparison, it is shown in Fig. 2 the development of budget deficits (ESA) in 2012 and 2013 in Romania and in the states from the euro area the EU.

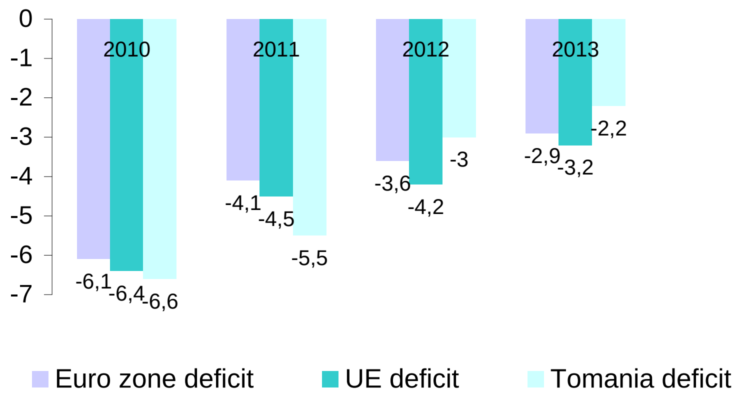


Fig.2. ESA budget deficits in Romania, the EU and the euro area countries (2012-2013)
[Source: Eurostat, Notificarea fiscala din luna octombrie, 2014]

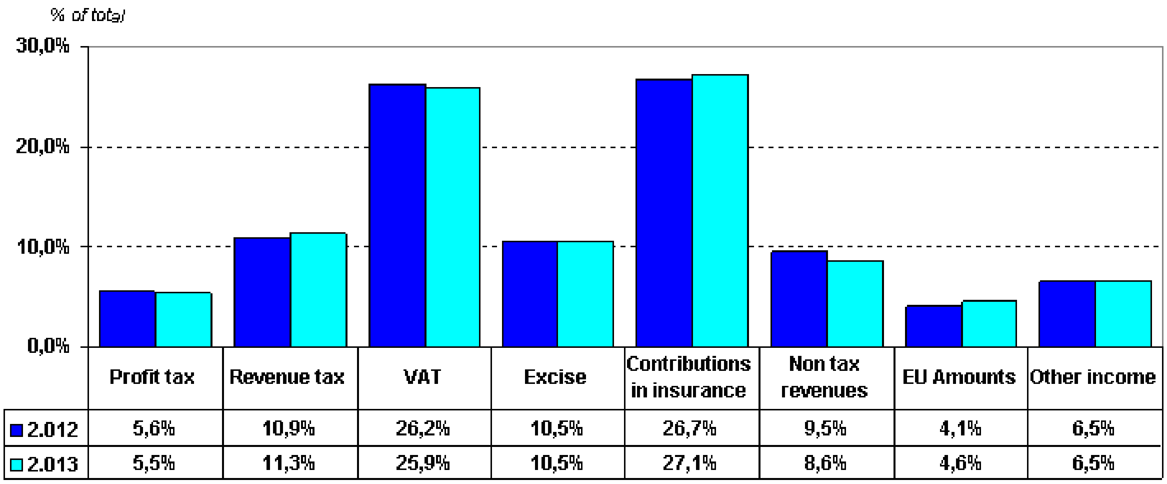
In this context, referring to measures of fiscal policy with influence in terms of ensuring social protection for people with low incomes and in stimulating the business community, we show that there were established: raising the minimum wage from 800 lei/ month to 850 lei/ month from 1 January 2014 and 900 lei/ month from 1 July 2014, indexation of pensions with 3.75%, and increase of guaranteed minimum income by 4.5%. At the same time, there were introduced: the application of the unitary pay law in sense of increase of wage for categories of employed young people with lower incomes, taxation of construction other than buildings and exemption from taxation of reinvested profit in technological equipment, and reducing the share of SSC of the employer (social security contribution) by five percent.

2. FISCAL POLICY ORIENTATION TOWARDS SOCIAL PROTECTION

In acknowledging the importance of stimulating consumption while ensuring social protection for certain vulnerable population (Varjan, 2014; Stanciu, 2007; Burciu *et al*., 2008; Hlaciuc & Morariu *et al*., 2012; Bercu & Petrișor, 2011), the need for state intervention in this is required without delay. That is why in this direction has recently acted by (GR / MFP, 2014) raising the minimum wage (from January 1, 2015: 975 lei and July 1, 2015: 1 050 lei), indexation of all pensions by 5% and increase of social benefits for the retired from 350 to 400 lei. Obviously, other measures are circumscribed to the same area: growth with 16% in allowances for individuals with disabilities, increasing allocation for families with income per family member below 530 lei, with 42 lei per child, increasing the placement allowances to 600 lei, increasing food allowance for adults with disabilities and elderly people in social care centers from 8 to 16 lei per day, staggered repayment of debt recovered from pensioners and people in child raising leave. In particular, there should be highlighted wage increases for health and social care staff with 100 lei in January 2015 as teacher salaries increase by 5% from 1 March 2015 and by a further 5% from 1 September 2015.

3. CHANGES IN THE STRUCTURE OF BUDGETARY EXPENDITURES AS A RESULT OF WAGE POLICY AND SOCIAL SAFETY NETS IN ROMANIA

Decrease of the maximum budget deficit after the crisis year (2008) has involved significant social costs due to adjustments that have focused mainly on the expenditure side of the budget; Structural reforms were aimed particularly in staff salary, budget public pension system and budgetary programming. After an evolution of approx. 5 years (2008-2012), affected by the global crisis recalled, the structure of the consolidated budget revenue of the Romanian state (totaled 200.4 billion lei, representing 31.9% share of GDP and an achievement of 97.5% compared to annual estimates) (GR/MFP, 2014) is as follows (Fig. 3).



	Profit tax	Revenue tax	VAT	Excise	Contributions in insurance	Non tax revenues	EU Amounts	Other income
2.012	5,6%	10,9%	26,2%	10,5%	26,7%	9,5%	4,1%	6,5%
2.013	5,5%	11,3%	25,9%	10,5%	27,1%	8,6%	4,6%	6,5%

Fig.3 The structure of consolidated budget revenues (2012 and 2013)
[Source: GR/MFP, 2014]

Consolidated general government expenditures totaled 216.2 billion lei in 2013. Compared to the previous year, the consolidated budget expenditures registered a nominal growth of 4% while their share in GDP declined by 1 percent. The economic structure of expenditures has recorded an increase of the share of personnel expenses by 1.8 pp. Reunification of budget salaries and payment obligations established legally determined that the personnel expenditure of the general consolidated budget in 2013 should grow by 13.3% compared to the previous year. In Fig. 4 we render the structure of the consolidated budget expenditures.

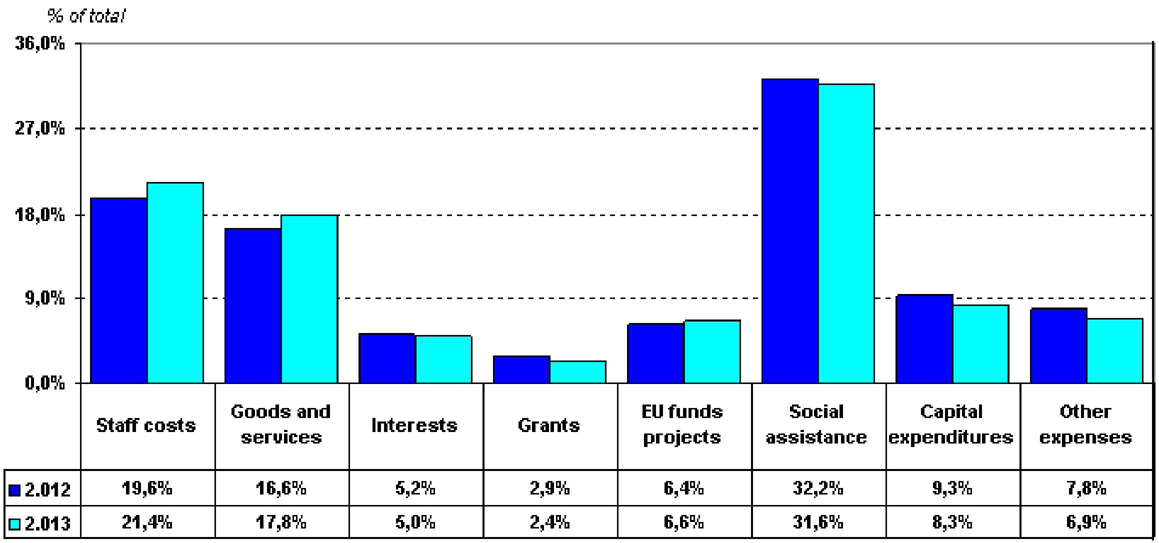


Fig.4. The structure of the consolidated budget expenditures (2012 and 2013)
[Source: GR/MFP, 2014]

As shown in Fig.5, not even at the end of the financial year 2014, things do not differ much regarding the share of expenditures in the structure of consolidated budget.

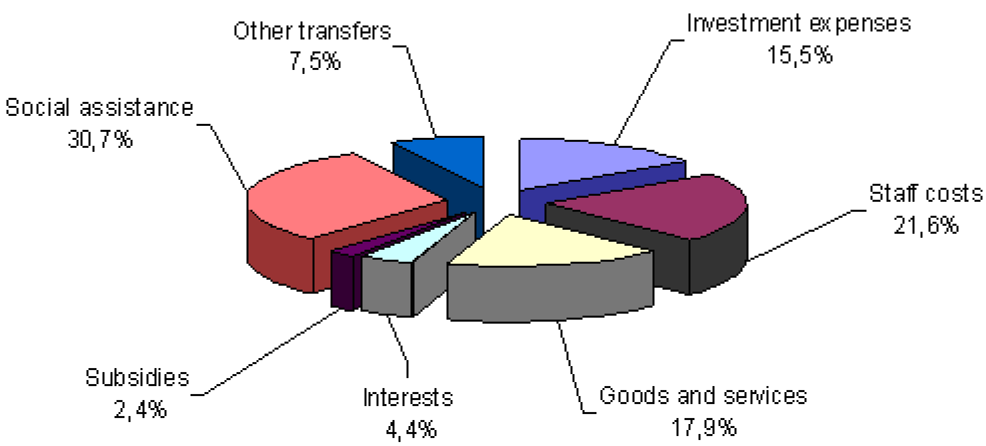


Fig.5 The structure of the consolidated budget expenditures (2014)
[Source: GR/MFP, 2014]

Expenditure on social assistance have increased compared to 2012 by 2%, which is explained by the increase of 8.5% from 1 July 2013 of the social aid (Law no. 416, 2001), to ensure a guaranteed minimum income, growth of family support allowance (Law no. 277, 2010) with 30% and the value of the pension point - by 4%.

Referring to the tendencies which occurred in the following year (2014) we highlight that personnel expenses increased (+ 4.0% - due to the increase of gross minimum wage to 850 lei from 1 January 2014 and to 900 lei 1 July 2014 and the payment of entitlements established by court decisions), social assistance (+ 3.6%), expenditure on subsidies (+ 6.9%).

Expenditure on social assistance recorded an increase of 3.6% compared to the same period last year, influenced by increasing the guaranteed minimum income and the increase of the pension point value.

4. CONCLUSIONS

As we revealed in the paper, the share of personnel expenses included in the consolidated general budget increased considerably in the past two years. The explanation was the reunification of budget salaries and the payment of overdue obligations established by court decisions.

What should be imposed in the immediate future is ensuring a sustainable level of spending on wages and pensions in the public sector, without neglecting targeting available resources to public investment of training in infrastructure, agriculture and rural development, energy and technology etc. In strict matters of personal spending, the Romanian government aims that the wage bill to fall in 2015 to 48.4 billion lei (6.8% of GDP), imparting a downtrend, being better correlated with productivity growth.

Application of the law on the unitary remuneration of personnel paid from public funds (the Framework Law no.284, 2010), and granting salary increases within wage bill agreed with international financial institutions, make the process of phased aligning of basic salaries of personnel paid from public funds to the levels provided by the legal framework already adopted to continue.

References

[1]. Bârcă, A. (2005). *Managementul resurselor umane*, Editura ASEM, Chişinău.
[2]. Bostan, I. (1999). *Recompensarea factorului muncă*, Editura Media-Tech, Iași, 1999.
[4]. Bostan, I.; Radu, P. (2003). *Controlul financiar și auditul intern la instituțiile publice*, Sedcom Libris, Iași.
[5]. Bostan, I. (2010). *Proceduri privind auditul public financiar şi al performanţei*, Tipo Moldova, Iaşi.
[6]. Burciu A. *et al*. (2008). *Introducere în management*, Editura Economică, București.
[7]. Chişu, Viorica-Ana (2002). *Manualul specialistului în resurse umane,* Casa de editură IRECSON, Bucureşti.
[8]. Eurostat, Notificarea fiscala din luna octombrie, 2014.
[9]. Florişteanu, Elena (2014). *Salarizarea personalului, Repere teoretice şi practice*, Editura Academiei Forţelor Terestre „Nicolae Bălcescu”, Sibiu.
[10]. GR/MFP, Guvernul României, Ministerul Finanţelor Publice (2014). Raport privind situaţia macroeconomică pe anul 2015 şi proiecţia acesteia pe anii 2016-2018, Bucureşti.
[11]. Hlaciuc, Elena & Morariu, Alunica (*et al*.) (2012). *Eficientizarea administraţiei publice locale prin aplicarea managementului modern al resurselor umane*, Editura Risoprint, Cluj-Napoca.
[12]. Legea no.416/2001 privind venitul minim garantat.
[13]. Legea no. 277/2010 privind alocaţia pentru susţinerea familiei.

[14]. Legea-cadru no. 284/2010 privind salarizarea unitară a personalului plătit din fonduri publice.
[15]. Mățăuan, G. (2014). *Managementul sistemului total de recompense (Notiuni financiare si Politici salariale - Curs)*, Universitatea București.
[16]. Morariu, Alunica (2015a). Implications of the evolution of the Romanian economy regarding the personnel salary in the public sector, *Ecoforum Journal*, Vol. 4, Special Issue 1, 2015, pp. 226-231.
[17]. Morariu, Alunica (2015b). Pluses and weaknesses in the applicable wage public sector staff, *ANNALS. ECONOMIC SCIENCE SERIES*, Vol. XXI, TIBISCUS University of Timişoara, Faculty of Economics, http://fse.tibiscus.ro/anale/anale-2015.htm
[18]. Oprea, F.; Petrişor, M.B. (2011). Public Expenditure Policy In The Context Of Economic Crisis - Challenges And Implications, *EUROPEAN INTEGRATION – NEW CHALLENGES*, Pages 986.
[19]. Piketty, Th. (2014). *Economia inegalităților*, Editura Polirom, Iași.
[20]. Tinică, G.; Bostan, I.; Grosu, Veronica (2010). Corelaţii privind creşterea economică şi evoluţia costurilor aferente maladiilor cronice, *Revista Romana de Bioetica*, 8(3), 15-24.
[21]. Stanciu, Mariana (2007). Politici sociale şi globalizare în ţările europene, *Calitatea vieţii*, XVIII, nr. 1–2, p. 137–148, http://www.revistacalitateavietii.ro/2007/CV-1-2-2007/8.pdf
[22]. Varjan, Daniela (2014). *Economie si politici sociale*, http://www.biblioteca-digitala.ase.ro/biblioteca/carte2.asp?id=374&idb

FINANCE

HOW DO CREDIT SPREADS AFFECT RISK ALLOCATION IN PUBLIC – PRIVATE PARTNERSHIPS?

Carlos CONTRERAS
Department of Applied Economics VI, Universidad Complutense de Madrid
Madrid, Spain
jc.contreras@ccee.ucm.es

Julio ANGULO
Quantitative Analysis, International Center for Infrastructure Solutions
Madrid, Spain
ja@grupoicis.com

***Abstract**: The impact of funding cost is an important dimension in the design of risk allocation in public–private partnerships (PPP), given the relevant leverage of project financing. However, the academic literature has paid little attention to this issue. The aim of this paper is to measure to what extent a higher cost of funding affect the choice of risk transfer by grantor governments. During the Great Recession, developing PPPs with market risk was a difficult task and high credit spreads were applied to project finance loans. This paper analyzes the optimal risk allocation in a PPP by using two models in which the government has the option to transfer availability risk or demand risk to a private partner. The paper finds that the credit spreads of project finance loans significantly affect the decisions on which type of risk should be transferred to private-sector parties when governments use PPPs.*
***Keywords**: Availability risk, Demand risk, Risk allocation, Credit spread, Project finance, Public–private partnership.*
***JEL classification:** G12, G32, H43, H44, H54.*

INTRODUCTION

Under a public–private partnership (PPP), several private sector partners form a consortium, the 'special purpose vehicle' (SPV), to deliver capital assets and/or services to a governmental agency on a long-term contract. A government using a PPP method may transfer the demand risk or only the availability risk to the private-sector party. After the start of the Great Recession in summer 2007, those banks specializing in project finance (PF) showed a greater preference for PPPs with availability risk than those with demand risk; a behavior that occurred even in those countries where sovereign risk was rapidly increasing. The results were a great difficulty in financing projects with market risk and the application of high credit spreads to loans financing this type of PPP. Risk allocation (RA) plays a critical role in privately financed infrastructure projects and public services, and the project performance is contingent on whether the adopted RA strategy is efficient. Regarding the use of PPPs as the procurement method for a social service, the academic literature has paid much attention to issues such as the impact of agency problems generated by asymmetric and incomplete information, whilst it has dealt less with the other aspect of PPPs: the reliance on private-sector finance. However, the impact of funding in RA is an important dimension given the relevant leverage of project financing. The aim of this paper is to measure to what extent a higher cost of funding affect the choice of risk transfer by grantor governments. We consider a PPP where a private partner builds a hospital and provides clinical and non-clinical services. The results, however, are generalizable to other types of PPPs. In our model, the public-sector party chooses between an availability risk scheme and an alternative one in which the market risk is shared with the private partner. The market risk for the private partner consists of receiving fewer revenues, because of the demand shortage (an insufficient number of patients). This takes place in a context in which the demand evolution follows a Brownian motion; and there is no hidden information for the players. To transfer demand risk to the private-sector party, the government is willing to pay a higher fee per patient, but this differential payment may not fully offset the impact on revenue arising from a shortage of demand. As a consequence, when market risk is transferred, lenders require higher credit spreads and shareholders higher equity premiums. The paper proceeds as follows. In section 2, we briefly address a number of issues regarding RA. In section 3, we propose a model in which credit spread plays a role in RA. We extend the models including a number of financial covenants. In section 4, a number of theoretical results are proposed. To contextualize those results, several numerical calculations are carried out as well. Section 5 concludes. The main finding of the paper is that the credit spreads significantly affect the decisions on which type of risk should be transferred to private partners when governments use PPP schemes.

THE ALLOCATION OF RISKS BETWEEN PUBLIC-SECTOR AND PRIVATE-SECTOR PARTIES

Risk sharing between governments and concessionaires is always a concern among practitioners and policy makers (see Engel et al., 2007) but, despite the existence of many complex risks that can interfere with the success of infrastructure projects, the private sector has been keen to take over the traditional role of the public sector in financing, procuring and managing infrastructure assets. However, even in the largest PPP projects, the risk management practices are often highly variable, intuitive, subjective and unsophisticated (Ng & Loosemore, 2007).The type, extent and allocation of risks in PPP contracts depend on the fundamentals of the arrangement, the contractual provisions and the degree to which the contract is enforceable. The infrastructure projects that are particularly subject to risk are those with large initial costs, high irreversibility (sunk costs), long-term durability of assets and complex management, as it is the case of hospitals.

There are basically two strands of relevant literature analyzing contract design and risk transfer in PPPs. On the one hand, the *new economics of regulation* stresses the trade-off between efficiency and rent extraction when the regulated firm has an information advantage. This approach is associated in particular with the book by Laffont and Tirole (1993), the paper by Schmidt (1996) and many subsequent works. On the other hand, the *incomplete contracting* literature emphasizes that market relations are problematic when the environment is complex due to the fear of ex-post *hold-ups* (greater investment by one party can trigger tougher ex-post bargaining by the other party).This literature is associated with the papers by Williamson (1975 and 1985), Grossman & Hart (1986), Hart & Moore (1990), Hart (1995) or Schmidt (1996) among many others. Typically, the process of RA between public and private sectors in infrastructure agreements is analyzed as a bargaining process. Each risk should be allocated to maximize the project value, taking account of moral hazard, adverse selection and risk-bearing preference. For the analysis of risk allocation in models with moral hazard in building and adverse selection in operation see Bentz et al. (2002) and Irwin (2003), among others. For models with moral hazard, in which the effort during the investment affects both the quality of the infrastructure and its operation cost, see for example Martimort & Pouyet (2006). Thus, RA is a means to provide the appropriate incentives for the private partner to perform according to the contract terms.

An important part of the literature considers that the public-sector party is less risk averse than the private-sector party because of its wider possibilities to diversify risk. The assumption of risk neutrality for the government provides a simple benchmark and can be an acceptable assumption if the PPP project does not represent a large share of the budget. Lewis & Sappington (1995) and Martimort & Sand-Zantman (2006) analyse the consequences of having risk-averse governments. In principal–agent models, a risk-averse firm is a short cut for agency problems preventing risk diversification. On the other hand, Martimort & Pouyet (2006) and others assume risk-averse concessionaires. Authors such as Klein (1997) and Hemming (2006) point out, however, that private firms can use capital markets to diversify risks at least as well as the government. Nevertheless, the academic literature has established the following criteria for RA: i) the public-sector party should bear risks that the private sector cannot control (or cannot control as well as the public-sector party) either in terms of likelihood of occurrence or in terms of impact; ii) the private-sector party should bear risks that the public sector can control (or can control better than the private-sector party) both in terms of likelihood of occurrence and in terms of impact; iii) the public-sector party and the private-sector party should share risks that the private sector can control in terms of impact but cannot control (or cannot control as well as the public-sector party) in terms of likelihood of occurrence; and iv) risk sharing may also be appropriate when risk is difficult to forecast and transferring risk to the private-sector party may result in an excessive risk premium (i.e. a high cost of capital).

Regarding this last issue, in many sectors the demand is difficult to predict accurately and the market risk is high. This is often the case when the expected revenues are calculated using forecasts of the future demand. In those cases, a full transfer of demand risk to the private-sector party might raise the cost of capital and funding substantially. To reduce the risk premiums and credit spreads, it might be desirable to cap the level of risk that the private-sector party bears; introducing some sort of risk sharing. The public-sector party may be in a better position than the private-sector party to acquire information on the likelihood of changes in users' needs. Furthermore, changes in public needs can be indirectly affected by changes in public sector policy. Thus, the risk of changes in public needs should generally be borne by the public-sector party, but optimal

RA should also provide incentives for the private-sector party to make the requested changes in the service provision at a reasonable cost to control the impact of risk. Whilst the private-sector party should be contractually obliged to provide the extra service, changes in public needs can be very costly for the public sector because of the strong bargaining position of the private-sector party locked into the contract, and because of the lack of accessible alternatives and cost benchmarks. This may make it preferable to introduce some sort of risk-sharing agreement between the private partner and the public partner. Risk sharing can also help to provide incentives for the private-sector party to acquire information on the cost of changes in the service and thus inform the decision on whether those changes are indeed necessary. This is also important since the private partner is often in a better position to identify the most appropriate means to satisfy the needs of the public sector services (regarding healthcare services, for example, see Nikolic & Maikisch, 2006).

Our analysis focuses on the impact of project financing on the optimal design of a project under a PPP scheme, but the route that we follow is different from the one that is usually discussed in the literature. We analyze the impact of credit spreads on the optimal RA between the government and the contractor, while the literature discusses a number of related but different topics. First, a body of the literature on financing public investments by private capital compares the higher outlays on construction for the public sector with the higher payments for a private investor (see Broadbent & Laughlin, 2003 and Irwin, 2008). Second, some papers investigate the benefit of using PPPs as a procurement method since they might bring in the expertise of outside financiers in evaluating risks. In this respect, bundling the tasks of looking for outside finance and operating assets could improve on the more traditional model of procurement, in which the cost of investment is paid through taxation and investment is not backed up by such a level of expertise within the public sphere. Often, this analysis takes place in a context involving moral hazard and in which bundling private finance and operation is optimal since outside financiers have access to some informative signals on the operator's effort level. The intuition for this result is that relying on outside finance makes the operator less risk averse, even though outside finance may exacerbate the moral hazard by introducing further risk sharing. The point is that, as the financial contract is made under a better information structure, the extra round of contracting with financiers has more benefits in terms of improved incentives than costs in terms of modified risk sharing. Third, the literature analyzes the distortionary cost of taxation as a rationale for the usage of PPPs in scenarios in which the government is or is not credit constrained (see Iossa & Martimort, 2009). Fourth, the comparative effects of subsidy finance, revenue guarantees and user-fee finance are also analyzed in the academic literature (see Engel et al., 2007).Fifth, some papers focus on the possible negative effect of external finance. It may arise a new agency problem between the consortium and the external investor, acting as equity provider (see Dewatripont & Legros, 2005).Sixth, in discussing the downsides of external financing for PPPs, some papers focus on the control rights when creditors may access the property in the case of default by borrowers (see Aghion & Bolton, 1992). Seventh, the literature also discusses whether the risk of bankruptcy is internalized if contractors are financially constrained when contracts are awarded. If the answer is negative, it can lead to aggressive bidding and success at the auctions, with the government paying the consequences later. In a scenario of projects that are *too important to fail*, as typically occurs in healthcare projects, the government may find it optimal ex post to rescue the project financially. The anticipation of such *soft budget constraints* (SBCs) would contribute to a further distortion at the auction. SBCs are an illustration of a lack of commitment or lack of completeness of contracts. Finally, some authors focus on the implications of financing costs and efficiency improvement on the capital structure of the companies running PPPs (see Gerrard, 2001; Schwartz et al., 2008 or Moszoro, 2010).The underlying assumption in some of these papers is that it might be optimal for the public partner to become a shareholder in the SPV if the domestic capital markets are well developed such that the public sector's participation may mitigate the cost premium.

RISK ALLOCATION IN A MODEL WITH VARIABLE CREDIT SPREADS

In this paper a governmental agency enters a long-term contractual arrangement with a private firm to deliver a healthcare service to society, according to which the agency pays a fee to a private partner managing a hospital, while patients do not pay for the healthcare services. The private partner takes responsibility for all clinical services. In this context, we compare two alternatives. In the first, the availability risk scheme (AR), the private partner signs an agreement in which the number of patients to treat is determined and the demand risk is fully retained by the public-sector party. In the second, the market risk scheme (MR), the private party takes the risk of demand. In the model there are three players: a risk-neutral agency of the government *G*, a private concessionaire firm *F* incorporated as a SPV and a syndicate of financial institutions *S*. For the provision of the services the construction of a hospital, with a cost of *H*, is required. We shall assume that the investment is upfront and there is no further capex. Instead of using the unbundled contracting method, according to which the government approaches a builder first and then a separate operator, *G* decides to tender a PPP, bundling various phases of contracting. The winner of the bid assumes responsibility for designing and building the hospital and for meeting the specified output; finances the investment and then operates the facility: the DBFO model. Usually the concessionaire also maintains the asset and the public sector retains ownership of it when the contract expires. To simplify, in our model, maintenance costs are included in the operating costs; at the end of the concession period, the hospital returns to the control and ownership of the public sector in good state. Frequently, to provide incentives for the private-sector party to look after the facility during the contract life and particularly towards the end of the contract, contract clauses provide for a final compensation payable to the private partner conditional on the state of the facility, once the contract expires. In our model, however, there is no such final compensation fee. We assume that the government, a benevolent social planner, retains the statutory risk, designs the contract, specifies the output requirements, designs the payment mechanism and decides the contract duration. In this regard, the government specifies that the winner of the bid *F* will undertake the investment in the hospital, and bear the financial risk, with the expectation of achieving a given level of return on the invested capital. In our model, the public-sector party does not provide the project with capital grants, guarantees, equity or subordinated loans. Finally, the government assumes that a syndicate of financial institutions *S* will give a single, senior and amortizing project finance loan to *F*, and will decide on its credit spread. The government runs a competitive auction to attract service providers and has two alternative tendering options, the availability risk scheme and the market risk scheme. Thus, the decision of the government refers to RA and it is assumed to be made in a context in which the government is able to allocate patients to different service centers to ensure compliance with the agreement in the case of availability risk scheme, but cannot control the healthcare demand in the market risk scheme. In addition, it is assumed that there is no hidden information regarding the operational cost or about the effort level applied by the private operator. Moreover, for simplicity, we assume that the service standards related to the output specifications are translated into measurable output indicators that can be verified by all the parties at a low monitoring cost; that the private operator meets the contract strictly; and that there are no bonus payments or penalties linked to the quality of the service provided. Finally, we assume that both the government and the concessionaire know the rules followed by the lenders when pricing the loan.

STOCHASTIC MODELING OF THE PUBLIC SERVICE DEMAND

The comparative analysis of concessions with and without market risk requires probabilistic modeling of demand D_t (treated patients in period t). Consider that D_t follows a Brownian motion such that

$$d\ln D_t = \mu dt + \sigma dW_t \qquad (1)$$

Where μ represents the average growth in each period and σ the expected volatility of the demand growth. D_t^e becomes a mean value of the distribution of values of the demand in period *t*, D_t^h is the mean value of the distribution of all the demand values greater than D_t^e and D_t^l is the mean value of the distribution of all the demand values lower than D_t^f. Thus, D_t^e can be estimated by:

$$D_t^e = D_0 e^{\left(\mu + \frac{\sigma^2}{2}\right)t} \qquad (2)$$

Where D_0 is the value of the demand at t = 0. Under these assumptions

$$p_t = \mathcal{N}\left(-\frac{\sigma\sqrt{t}}{2}\right) and \ 1 - p_t = \mathcal{N}\left(\frac{\sigma\sqrt{t}}{2}\right) \qquad (3)$$

Where p_t is the probability of facing a high demand D_t^h and where $1\text{-}p_t$ is the probability of facing a low demandD_t^l.

$\mathcal{N}$(x) is the probability of normal cumulative distribution up to value x.

Meanwhile, the value of D_t^hcan be estimated by

$$D_t^h = (1 + \omega_t)D_t^e = D_t^e \frac{\mathcal{N}\left(\frac{\sigma\sqrt{t}}{2}\right)}{\mathcal{N}\left(-\frac{\sigma\sqrt{t}}{2}\right)} \qquad (4)$$

Similarly

$$D_t^l = \frac{D_t^e}{1+\omega_t} = D_t^e \frac{\mathcal{N}\left(-\frac{\sigma\sqrt{t}}{2}\right)}{\mathcal{N}\left(\frac{\sigma\sqrt{t}}{2}\right)} (5)$$

We note that (ω_t) is given by [6] and it holds that $\omega \geq 0$:

$$\omega_t = \frac{\mathcal{N}\left(\frac{\sigma\sqrt{t}}{2}\right) - \mathcal{N}\left(-\frac{\sigma\sqrt{t}}{2}\right)}{\mathcal{N}\left(-\frac{\sigma\sqrt{t}}{2}\right)} \quad (6)$$

Combining the above expressions, we obtain

$$p_t\left(D_t^h - D_t^e\right) = D_t^e\left\{\mathcal{N}\left(\frac{\sigma\sqrt{t}}{2}\right) - \mathcal{N}\left(-\frac{\sigma\sqrt{t}}{2}\right)\right\} \quad (7)$$

and it obviously holds that

$$p_t D_t^h + (1-p_t) D_t^l = D_t^e (7')$$

The availability risk scheme

In the availability risk scheme *AR*, the utility function of the government $U^G(AR)_t$ is given by [8]:

$$U^G(AR)_t = (u-m) D_t^f - \alpha H + \tau \Pi_t^{AR} \quad (8)$$

where *u* is the unitary social benefit of the healthcare service; *m* is the unitary payment per recorded service; D_t^f is the agreed number of patient to be treated; α reflects the parameter of a second government payment; τ is the corporate tax rate (for simplification it is assumed to be constant over time); and Π_t^{AR} is the pre-tax profit of the concessionaire. In addition we assume that

$$D_t^f = (1-d) D_t^e = D_0 e^{\left(\mu + \frac{\sigma^2}{2}\right)t} \quad (9)$$

Where D_0 is an initial demand level; μ is the historic average growth of the demand for a determined period, σ is the historic volatility of the demand for the same period, and *d* is a discount factor, such that the four parameters are agreed between the government and the private-sector party at the beginning of the contract. Consequently, in this scheme, the future path of demand is deterministic. Those terms that do not use the subscript (t) are assumed to be equal for all periods.

On the other hand, Π^{AR}, assuming availability risk, is given by

$$\Pi_t^{AR} = \alpha H + (m-\beta) D_t^f - L_{t-1}(i+\gamma) - \frac{H}{n} \quad (10)$$

where *L* the outstanding project finance loan; *i* the risk-free rate for the relevant project finance maturity; γ the credit spread of the loan; $(\frac{H}{n})$ is the annual depreciation of the asset, such that *n* is the concession length; the operational costs are proportional to the demand of the project: β reflects the observable unitary operating cost, such that $m > \beta$. Note that, unlike other models that include potential externalities (improving the quality

of the infrastructure may reduce or increase the operational cost of the operator), here the unitary operational cost depends only on the demand.
The credit spread can be proxied by

$$\gamma = \lambda\left(\sum_{1}^{n}(1+i')^{-t}\right)^{-1}\sum_{1}^{n}(1+i')^{-t}\frac{L_{t-1}}{\alpha H+(m-\beta)D_t^f} \quad (11)$$

where we assume that λ is a constant, indicating the risk price based on both the credit quality of the concessionaire and capitalization requirements of the lenders group. See Kleimeier & Megginson (2000), Blanc-Brude & Stranger (2007), Dailmani & Hauswald (2007), Kong et al.(2008), Sorge & Gadanecz (2008), Corielli et al. (2010), Girardone & Snaith (2011) or Sorge (2011) on the determinants of credit spreads in project finance.

3.3. The market risk scheme

As its second option, the government can tender the PPP through a market risk scheme *MR*, in which the concessionaire shares the demand risk with the government. It may happen that the demand takes levels substantially lower than those set for the case of the availability risk scheme. To compensate the private operator for thisrisk,the government decides to use a different payment system ($m' D_t$). The utility function of the government $\widehat{U}^G(MR)_t$ is given by

$$\widehat{U}^G(MR)_t = p_t[(u-m')D_t^h]+(1-p_t)[\,(u-m')D_t^l]-\alpha\, H+\,\tau\,\widehat{\Pi}_t^{MR1} \quad (12)$$

where p_t is the probability of facing a high demand D^h. Given that $D_t^e = p_t D_t^h + (1-p_t)D_t^l$, then [12] can be rewritten as

$$\widehat{U}^G(MR)_t = (u-m')D_t^e-\alpha\, H+\,\tau\,\widehat{\Pi}_t^{MR1} \quad (12')$$

In a scenario with market risk, the annual expected profit of *F* is given by:

$$\widehat{\Pi}_t^{MR} = p_t\left[(m'-\beta)D_t^h+\alpha\, H-\,L_{t-1}(i+\gamma')-\frac{H}{n}\right]+(1-p_t)\left[(m'-\beta)D_t^l+\alpha\, H-\,L_{t-1}(i+\gamma')-\frac{H}{n}\right] \quad (13)$$

Equivalently,

$$\widehat{\Pi}_t^{MR} = \,(m'-\beta)D_t^e+\alpha\, H-\,L_{t-1}(i+\,\gamma')-\frac{H}{n} \quad (13')$$

Now, the credit spread can be proxied by

$$\gamma' = \lambda'\left(\sum_{1}^{n}(1+i')^{-t}\right)^{-1}\sum_{1}^{n}(1+i')^{-t}\frac{L_{t-1}}{\alpha H+(m'-\beta)D_t^e} \quad (14)$$

Such that $\lambda' > \lambda$, where that λ' can be expressed as

$$\lambda' = \lambda(1+k\sigma) \quad (15)$$

where *k*> 0. The scheme with demand risk incorporates an additional risk with respect to the availability risk scheme because of the random feature of the demand. This impact can be represented by a multiplier *k* of the demand volatility. Given that $\prod_t^{MR}$may be less than $\prod_t^{AR}$when $(m'-\beta)D_t-(m-\beta)D_t^f < L_{t-1}(\gamma'-\gamma)$, lending to this type of project is riskier, and lenders *S* charge a higher credit spread. The intuition is straightforward: the profit of the concessionaire is less for those scenarios in which the difference of revenues is negative or if it is positive but insufficient to offset the higher financing costs of the concessionaire.

On the one hand, in this model, the government determines *m* and m´ and chooses to tender a PPP with demand risk when

$$\sum_{1}^{n}(1+i')^{-t}[\widehat{U}^{G}(MR)_{t}-U^{G}(AR)_{t}]>0 \qquad (16)$$

Note that the rate used to discount the flows (i´) may or may not coincide with the risk-free rate (i). For a recent analysis of the impact of discount rates on PPPs, see Contreras (2014).Alternatively, in this particular case we can rewrite (16) as,

$$\sum_{1}^{n}(1+i')^{-t}\{[(1-\tau)(m-\beta)-(u-\beta)](D_{t}^{f}-D_{t}^{e})-(1-\tau)(m'-m)D_{t}^{e}-\tau(\gamma'-\gamma)L_{t-1}\}>0 \qquad (17)$$

Equivalently,

$$\sum_{1}^{n}(1+i')^{-t}\left\{[(1-\tau)(m-\beta)-(u-\beta)](D_{t}^{f}-D_{t}^{e})-(1-\tau)(m'-m)D_{t}^{e}-\tau\lambda L_{t-1}\left[\left(\sum_{1}^{n}(1+i')^{-j}\right)^{-1}\sum_{1}^{n}(1+i')^{-j}L_{j-1}\left\{\frac{1+k\sigma}{\alpha H+(m'-\beta)D_{j}^{e}}-\frac{1}{\alpha H+(m-\beta)D_{j}^{f}}\right\}\right]\right\}>0 \qquad (17')$$

On the other hand, private agents bidding for the project know the conditions ultimately included in the tender by *G* once the choice regarding the type of PPP has been adopted. When setting their bid, *α*, *m* and *m´* the candidates aim to achieve a minimum return on their equity investment (ν) such that

$$\nu(AR)=(i+\Gamma^{AR}) \qquad (18)$$

$$\hat{\nu}(MR)=[i+\Gamma^{AR}(1+g)] \qquad (19)$$

Where *Γ* is the equity premium. It is assumed that *g*> 0, and that *ν* is calculated as the internal rate of return of the cash flows, which include, as a negative flow, the initial equity contribution (H-L) and, as positive ones, all the dividends paid by the SPV to the shareholders during the concession period, as well as a final extraordinary dividend (*ed*) such that

$$CF_{t}^{AR}=-(H-L)_{0}+d_{1}^{AR}+d_{2}^{AR}+\cdots+d_{n}^{AR}+ed_{n}^{AR} \qquad (20)$$

$$\widetilde{CF}_{t}^{MR}=-(H-L)_{0}+\widetilde{d}_{1}^{MR}+\widetilde{d}_{2}^{MR}+\cdots+\widetilde{d}_{n}^{MR}+\widetilde{ed}_{n}^{MR} \qquad (21)$$

In a model without financial covenants, the annual dividends paid match the net income:

$$d_{t}^{AR}=(1-\tau)\Pi_{t}^{AR} \qquad (22)$$

$$\widetilde{d}_{t}^{MR}=(1-\tau)\widehat{\Pi}_{t}^{MR} \qquad (22')$$

The extraordinary dividends paid at the end of the concession period, once all the debt has been repaid, are given by

$$ed_{n}^{AR}=\sum_{1}^{n}\left[(1-\tau)\left[\alpha H-(m-\beta)D_{t}^{f}-L_{t-1}(i+\gamma)-\frac{L}{n}\right]-d_{t}^{AR}\right] \qquad (23)$$

$$\widetilde{ed}_{n}^{MR}=\sum_{1}^{n}\left[(1-\tau)\left[\alpha H-(m'-\beta)D_{t}^{e}-L_{t-1}(i+\gamma b)-\frac{L}{n}\right]-d_{t}^{MR}\right] \qquad (23')$$

The model extended with financial covenants

In practice, project finance is the preferred financial technique for large infrastructures, when the private sector is involved. Typically the sponsors commit an amount of capital to obtain additional sources: non-recourse or limited recourse debt provided by lenders or by bondholders. The repayment of these financial facilities depends primarily on the cash flow generated by the asset being financed. The SPV pledges the income stream as collateral to borrow the funds; and its dividend policy is habitually affected by some requirements imposed by the lenders. Thus, the payout policy is subject to at least five financial covenants, represented by $\theta_1, \theta_2, \theta_3, \theta_4$ and θ_5. Most of the project finance contracts include cash sweep clauses, which regulate the mandatory use of excess free cash flows to pay down outstanding debt rather than distributing it to shareholders. In our model, the required covenants are identical for the cases of availability risk and market risk, while the difference in the loan contract is reflected in the credit spread. The initial gearing ratio (θ_1) measures the degree to which the SPV is funded by the owner's funds versus the creditor's funds and must be equal to or lower than a given value:

$$\frac{L}{H} \leq \theta_1 \tag{24}$$

The debt/EBITDA ratio must be equal to or lower than a given value such that:

$$\frac{L_{t-1}}{\alpha H + (m - \beta)D_t^f} \leq \theta_2^{AR} \tag{25}$$

$$\frac{L_{t-1}}{\alpha H + (m' - \beta)D_t^e} \leq \theta_2^{MR} \tag{25'}$$

The debt service cover ratio (DSCR) must be equal to or higher than a given value. This ratio provides a snapshot of the ability to pay in the short term. It is calculated as the quotient of the free cash flow available to repay debt (FCF) divided by the amount of debt service (DS) such that

$$\frac{FCF_t}{DS_t} \geq \theta_3 \tag{26}$$

where

$$FCF_t^{AR} = (1-\tau)\left[\alpha H - (m - \beta)D_t^f - L_{t-1}(i + \gamma) - \frac{L}{n}\right] \tag{27}$$

$$\widetilde{FCF}_t^{MR} = (1-\tau)\left[\alpha H - (m' - \beta)D_t^e - L_{t-1}(i + \gamma b) - \frac{L}{n}\right] \tag{27'}$$

and

$$DS_t^{AR} = \left[L_{t-1}(i + \gamma) + \frac{L}{n}\right] \tag{28}$$

$$\widetilde{DS}_t^{MR} = \left[L_{t-1}(i + \gamma b) + \frac{L}{n}\right] \tag{28'}$$

where $\left(\frac{L}{n}\right)$ is the annual loan repayment.

The loan life coverage ratio (LLCR) must be equal to or above a given value. This ratio is a measure of the ability to pay over the life of a project finance loan. It is calculated as the present value of the FCF generated over the lifespan of the project divided by the outstanding debt in the project:

$$\frac{FCF^{PV}}{L} = \theta_4 \tag{29}$$

where

$$FCF^{PV}(AR) = \sum_{1}^{n} \frac{(1-\tau)}{(1+i')^{t}}\left[\alpha H + (m-\beta)D_t^f - L_{t-1}(i+\gamma) - \frac{L}{n}\right] \tag{30}$$

$$FCF^{PV}(MR) = \sum_{1}^{n} \frac{(1-\tau)}{(1+i')^{t}}\left[\alpha H + (m-\beta)D_t^e - L_{t-1}(i+\gamma b) - \frac{L}{n}\right] \tag{30'}$$

Finally, the debt service reserve account (DSRA) must be equal to or higher than a given value. This covenant works as an additional security measure for lenders and is generally a deposited amount of money sufficient to cover the projected debt service obligations for a given number of months. These ratios are calculated by:

$$DSRA_t^{AR} = 12\left[\frac{\sum_1^n [FCF_t^{AR} - d_t^{AR}]}{DS_t^{AR}}\right] = \theta_5 \tag{31}$$

$$\widetilde{DSRA}_t^{MR} = 12\left[\frac{\sum_1^n [\widetilde{FCF}_t^{MR} - \widetilde{d_t^{MR}}]}{\widetilde{DS}_t^{MR}}\right] = \theta_5 \tag{31'}$$

After the introduction of the described financial covenants, the choice of a PPP with market risk by the government is still driven by equation [14], but now the return on equity for the private investor is affected by these restrictions.

THEORETICAL AND NUMERICAL RESULTS

In the first part of this section we provide some theoretical results about the impact of various relevant parameters on the governmental decision to procure the healthcare services through one or another type of PPP. The government chooses the scheme with shared market risk when A $= \sum_1^n (1+i')^{-t}[\widetilde{U}^G(MR)_t - U^G(AR)_t)] > 0$, as expressed in equation [18'], such that

$$A = \sum_{1}^{n}(1+i')^{-t}\left\{[(1-\tau)(m-\beta)-(u-\beta)](D_t^f - D_t^e) - (1-\tau)(m'-m)D_t^e - \tau\lambda L_{t-1}\left[\left(\sum_{1}^{n}(1+i')^{-j}\right)^{-1}\sum_{1}^{n} jL_{j-1}\left\{\frac{1+k\sigma}{\alpha H+(m'-\beta)D_j^e} - \frac{1}{\alpha H+(m-\beta)D_j^f}\right\}\right]\right\} \tag{32}$$

Denoting

$$\Delta = \frac{m'-m}{m} \tag{33}$$

$$\Omega = \frac{u-m}{m} \tag{34}$$

We can rewrite

$$A = -\sum_{1}^{n}(1+i')^{-t}\left\{[\tau(m-\beta)+m\Omega](D_t^f - D_t^e) + (1-\tau)\Delta m D_t^e + \tau\lambda L_{t-1}\left[\left(\sum_{1}^{n}(1+i')^{-j}\right)^{-1}\sum_{1}^{n}(1+i')^{-j}L_{j-1}\left\{\frac{1+k\sigma}{\alpha H+(m(1+\Delta)-\beta)D_j^e} - \frac{1}{\alpha H+(m-\beta)D_j^f}\right\}\right]\right\} \tag{35}$$

The sensitivity of A with respect to $\Delta$is given by

$$\frac{\partial A}{\partial \Delta} = -\sum_{1}^{n}(1+i')^{-t}\left\{(1-\tau)mD_t^e - \tau\lambda L_{t-1}\left[\left(\sum_{1}^{n}(1+i')^{-j}\right)^{-1}\sum_{1}^{n}(1+i')^{-j}\frac{L_{j-1}(1+k\sigma)mD_j^e}{(\alpha H+(m(1+\Delta)-\beta)D_j^e)^2}\right]\right\} \tag{36}$$

Moreover, the sensitivity of A with respect to Ω is given by

$$\frac{\partial A}{\partial \Omega} = -m \sum_{1}^{n} (1+i')^{-t} \left(D_t^f - D_t^e\right) \quad (37)$$

In addition, the sensitivity of A with respect to μ and σ are given by

$$\frac{\partial A}{\partial \mu} = -\sum_{1}^{n} (1+i')^{-t} t \left\{ [\tau(m-\beta) + m\Omega](D_t^f - D_t^e) + (1-\tau)\Delta m D_t^e - \tau\lambda L_{t-1} \left[\left(\sum_{1}^{n} (1+i')^{-j}\right)^{-1} \sum_{1}^{n} (1+i')^{-j} L_{j-1} \left\{ \frac{(1+k\sigma)(m(1+\Delta)-\beta)D_j^e}{\left(\alpha H + (m(1+\Delta)-\beta)D_j^e\right)^2} - \frac{(m-\beta)D_j^f}{\left(\alpha H + (m-\beta)D_j^f\right)^2} \right\} \right] \right\} \quad (38)$$

$$\frac{\partial A}{\partial \sigma} = \sigma \frac{\partial A}{\partial \mu} - \sum_{1}^{n} (1+i')^{-t} t \left\{ [\tau(m-\beta) + m\Omega](D_t^f - D_t^e) + (1-\tau)\Delta m D_t^e + \tau\lambda k L_{t-1} \left[\left(\sum_{1}^{n} (1+i')^{-j}\right)^{-1} \sum_{1}^{n} \frac{(1+i')^{-j} L_{j-1}}{\alpha H + (m(1+\Delta)-\beta)D_j^e} \right] \right\} \quad (39)$$

In the second part of this section we present an illustrative case example to demonstrate how assumptions about the credit spread determination affect the optimal allocation of risks. We use a number of assumptions to calibrate the model, such that the government is indifferent between the availability risk scheme and the market risk scheme. The main characteristic of the hypothetical hospital, are show in table 1. In Robinson & Luft, 1985 and Martín et al., 2012 can be found main economic parameters for a hospital.

Table 1: Assumptions about the project

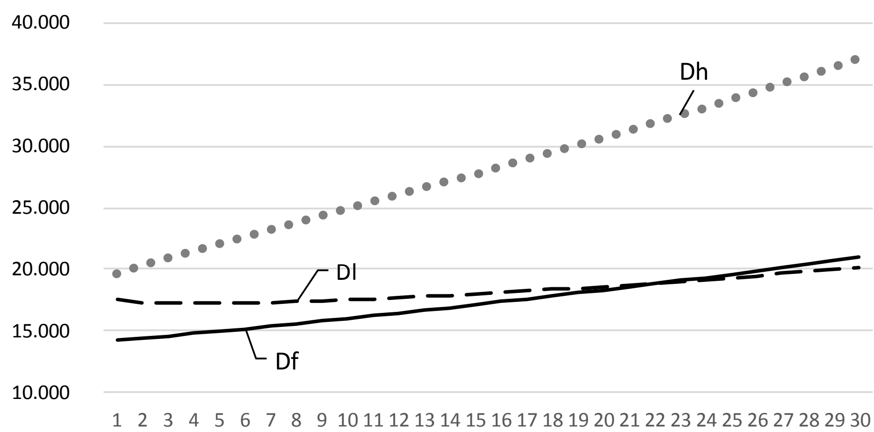
Variable	Concept	Amount	Unit
H	Construction cost of the hospital	150	€ million
n	Contract length	30	years
	Average investment per bed	0.5	€ million
	Hospital size (number of beds)	300	beds
	Average period of hospitalization	6.00	days
D_0	First year demand	18,250	patients
d	Demand discount for AR	23.34	%
D^f_0	Number of agreed patients	13,991	patients
α	Annual payment/H	4.0	%
β	Operating cost per patient	3,500	€
Ʊ	(u-m)/m	6.00	%
u	Social benefit per patient	4,468	€
m	Payment per patient in AR	4,215	€
Δ	(m -m')/m	2.5	%
m'	Payment per patient in MR	4,320	€
v (AR)	Return on equity in AR	8.1	%
v (MR)	Return on equity in MR	8.9	%

Main assumption about the market and the project finance are shown in table 2. Note that, according to the assumptions, in spite of the discount applied to the availability scheme in terms of number of patients to be treated, the lower part of the expected range in the market risk scheme falls below the path agreed in the availability scheme level. See figure 1.

Table 2 Assumptions about the market and the project finance loan

Variable	Concept	Amount	Unit
μ	Average growth of demand	1.1	%
σ	Volatility of demand growth	5.33	%
τ	Tax rate	25.0	%
i	Benchmark yield	3.00	%
Y	Credit spread (AR)	2.66	%
Y'	Credit spread (MR)	4.74	%
θ^1	Gearing ratio ≤	75	%
θ^2	Debt/Ebitda ≤	3.00	x
θ^3	Debt service coverage ratio (DSCR) ≥	1.15	x
θ^4	Loan life coverage ratio (LLCR) ≥	1.60	x
θ^5	Debt service reserve account (DSRA) ≥	9.00	months

Figure 1 Comparative evolution of the number of patients per year



For a better interpretation of the choice between a scheme with availability risk and a scheme with demand risk, we can rename the key parameter *A* (which is in absolute levels of Euros) into *B*. Now *B* is the sum of the present value of the difference between utilities obtained by the government in both schemes, in terms of the cost of building the hospital such that

$$B = \frac{\sum_1^n (1+i)^{-t}\left[\tilde{U}^G(MR)_t - U^G(AR)_t\right]}{H} \quad [40]$$

The simulations we offer bellow have a two-fold objective. First, to determine the sensitivity of the risk allocation choice to differences in credit spreads that are required in availability and market risk schemes. Secondly, to test for the robustness of the results.

The main results of the numerical exercise are as follow:

- Each basis point in the difference of the relevant credit spreads (γ´- γ) implies 2.4 basis points in *B*. See table 3.
- For differences in credit spreads (γ´- γ) below 2.88% the market risk scheme would be preferred. See table 3.
- The consideration of alternative scenarios for the risk-free rate does not significantly affect the above results. See table 3.

Table 3: Sensitivity of the choice between availability risk and market risk to differences in credit spreads (various scenarios of risk-free rates)

i = 2.5%			i = 3.0%			i= 3.5%		
Y' - Y	(Ug^{AR}-UgMR)	Decision	Y' - Y	(Ug^{AR}-UgMR)	Decision	Y' - Y	(Ug^{AR}-UgMR)	Decision
1,43%	-3,44%	Market risk	1,46%	-3,06%	Market risk	1,50%	-2,72%	Market risk
1,78%	-2,66%		1,82%	-2,29%		1,86%	-1,97%	
2,12%	-1,88%		2,17%	-1,53%		2,22%	-1,22%	
2,47%	-1,09%		2,52%	-0,76%		2,58%	-0,47%	
2,81%	-0,31%		2,88%	0,00%	Indifference	2,94%	0,27%	Availability risk
3,16%	0,47%	Availability risk	3,23%	0,76%	Availability risk	3,30%	1,02%	
3,50%	1,26%		3,58%	1,53%		3,66%	1,77%	
3,85%	2,04%		3,93%	2,29%		4,02%	2,52%	
4,19%	2,82%		4,29%	3,06%		4,38%	3,26%	

Each percentage point of the excess of the payment per patient paid by the government in the market risk scheme relative to the payment in availability risk scheme (Δ) implies 8.6 percentage points in *B*. This ratio is not affected by the difference of the relevant credit spreads (γ´- γ). See table 4.

Table 4: Sensitivity of the choice between availability risk and market risk to differences in credit spreads (various payment scenarios)

	Excess of payment per patient in market risk scheme (Δ)						
γ' - γ	1,75%	2,00%	2,25%	2,50%	2,75%	3,00%	3,25%
1,46%	**-9,60%**	**-7,42%**	**-5,24%**	**-3,06%**	**-0,87%**	1,31%	3,50%
1,82%	**-8,82%**	**-6,64%**	**-4,47%**	**-2,29%**	**-0,12%**	2,06%	4,25%
2,17%	**-8,03%**	**-5,87%**	**-3,70%**	**-1,53%**	0,64%	2,81%	4,99%
2,52%	**-7,24%**	**-5,09%**	**-2,93%**	**-0,76%**	1,40%	3,56%	5,73%
2,88%	**-6,46%**	**-4,31%**	**-2,15%**	0,00%	2,16%	4,32%	6,48%
3,23%	**-5,67%**	**-3,53%**	**-1,38%**	0,76%	2,91%	5,07%	7,22%
3,58%	**-4,88%**	**-2,75%**	**-0,61%**	1,53%	3,67%	5,82%	7,96%
3,93%	**-4,10%**	**-1,97%**	0,16%	2,29%	4,43%	6,57%	8,71%
4,29%	**-3,31%**	**-1,19%**	0,93%	3,06%	5,19%	7,32%	9,45%

Each percentage point in the reduction concerning the number of treated patients in the availability risk scheme (where the demand is not affect by the volatility) implies 1.29 percentage points in *B*. This ratio is hardly affected by the difference of the relevant credit spreads (γ´- γ). See table 5.

Table 5: Sensitivity of the choice between availability risk and market risk to differences in credit spreads (various discount off the demand scenarios)

	D_o^f/D_o^e						
γ' - γ	25,30%	24,55%	23,80%	23,05%	22,30%	21,55%	20,80%
1,46%	**-5,59%**	**-4,62%**	**-3,66%**	**-2,69%**	**-1,72%**	**-0,76%**	0,21%
1,82%	**-4,83%**	**-3,86%**	**-2,89%**	**-1,93%**	**-0,96%**	0,01%	0,97%
2,17%	**-4,06%**	**-3,10%**	**-2,13%**	**-1,16%**	**-0,20%**	0,77%	1,74%
2,52%	**-3,30%**	**-2,33%**	**-1,36%**	**-0,40%**	0,57%	1,53%	2,50%
2,88%	**-2,53%**	**-1,57%**	**-0,60%**	0,37%	1,33%	2,30%	3,26%
3,23%	**-1,77%**	**-0,80%**	0,17%	1,13%	2,10%	3,06%	4,03%
3,58%	**-1,00%**	**-0,04%**	0,93%	1,90%	2,86%	3,83%	4,79%
3,93%	**-0,24%**	0,73%	1,69%	2,66%	3,63%	4,59%	5,56%
4,29%	0,53%	1,49%	2,46%	3,43%	4,39%	5,36%	6,32%

Each percentage point in the demand volatility implies between 0.6 and 1.4 percentage points in *B*. This ratio is affected by the difference of the relevant credit spreads (γ´- γ), such that an increase of each basis point amplifies the impact by 29 basis points. See table 6.

Table 6: Sensitivity of the choice between availability risk and market risk to differences in credit spreads (various volatility of demand scenarios)

	σ						
γ' - γ	4,00%	5,00%	6,00%	7,00%	8,00%	9,00%	10,00%
1,46%	**-4,86%**	**-4,24%**	**-3,64%**	**-3,06%**	**-2,49%**	**-1,95%**	**-1,42%**
1,82%	**-4,42%**	**-3,69%**	**-2,98%**	**-2,29%**	**-1,62%**	**-0,97%**	-0,35%
2,17%	**-3,98%**	**-3,14%**	**-2,33%**	**-1,53%**	**-0,75%**	0,00%	0,73%
2,52%	**-3,53%**	**-2,59%**	**-1,67%**	**-0,76%**	0,12%	0,97%	1,80%
2,88%	**-3,09%**	**-2,04%**	**-1,01%**	0,00%	0,99%	1,95%	2,88%
3,23%	**-2,65%**	**-1,49%**	**-0,35%**	0,76%	1,86%	2,92%	3,95%
3,58%	**-2,21%**	**-0,94%**	0,31%	1,53%	2,72%	3,89%	5,02%
3,93%	**-1,77%**	**-0,39%**	0,96%	2,29%	3,59%	4,86%	6,10%
4,29%	-1,33%	0,16%	1,62%	3,06%	4,46%	5,84%	7,17%

CONCLUSIONS

This paper analyzes the optimal risk allocation in a healthcare project consisting of the construction of a health facility and the going provision of its clinical and non-clinical services under a PPP scheme. We use a model in which the government has the option to transfer availability risk or demand risk to a private partner. When market risk is transferred, the possible negative impact on the concessionaire's profits implies that lenders require higher credit spreads. The paper finds, first that credit spreads of project finance loans significantly affect the optimal decision on the risk allocation in health PPP; and secondly, that these results appear to be robust to changes in key parameters of the model.

References

1. Aghion, P & Bolton P 1992,"An incomplete contracts approach to financial contracting", *Review of Economic Studies* 59(3): 473–494.
2. Bentz A, Grout PA & Halonen M 2002,"Public–private partnerships: What should the state buy?"*March Dartmouth College*, mimeo.
3. Blanc-Brude F & Stranger R2007,"How banks price loans to public–private partnerships: Evidence from the European markets", *Journal of Applied Corporate Finance* 19(4): 94–106.
4. Broadbent J&Laughlin R 2003,"Public–private partnerships: An introduction"*Journal of Accounting, Auditing & Accountability* 16(3): 332–341.
5. Contreras C 2014,"Value for money: To what extent does discount rate matter?"*Revista de Economía Aplicada* 22(66): 93–112.
6. Corielli F, Gatti S & Steffanoni A 2010, Risk shifting through nonfinancial contracts: Effects on loan spreads and capital structure of project finance deals. *Journal of Money, Credit and Banking*, 42(7): 1295–1320.
7. Dailami M & Hauswald R 2007,"Credit-spread determinants and interlocking contracts: A study of the Ras Gas project", *Journal of Financial Economics* 86(1): 248–278.
8. Dewatripont M & Legros P 2005,"Public–private partnerships: Contract design and risk transfer", *EIB Papers*, 10(1): 120–145.
9. Engel E, Fisher R & Galetoic A 2007,*The Basic Public Finance of Public–Private-Partnerships*, Economic Growth Center Yale University, Center Discussion Paper 957.
10. Gerrard M 2001,"Public–private partnerships", *Finance and Development*, 38(3),1 September.
11. Girardone, C & Snaith, S 2011,"Project finance loan spreads and disaggregated political risk", *Applied Financial Economics*, 21(23): 1725-1734.
12. Grossman SJ& Hart OD 1986,"The costs and benefits of ownership: A theory of vertical and lateral integration", *Journal of Political Economy*: 691–719.
13. Hart, O 1995,*Firms, Contracts, and Financial Structure*,Oxford: Oxford University Press.
14. Hart O& Moore J 1990,"Property rights and the nature of the firm", *Journal of Political Economy*: 1119–1158.
15. Hemming R 2006, *Public–Private Partnerships, Government Guarantees, and Fiscal Risk*, Washington: International Monetary Fund.
16. Iossa E&Martimort D (2009) *The theory of incentives applied to the transport sector. Available* at SSRN 1346884.
17. Irwin T 2003,Incomplete contracts and public ownership: Remarks, and an application to public–private partnerships.*Economic Journal*,113(486): C69–C76.
18. Irwin T 2008,*Controlling Spending Commitments in PPPs. Public Investment and Public-Private Partnership: Addressing Infrastructure Challenges and Managing Fiscal Risks*. Washington: International Monetary Fund.
19. Kleimeier S& Megginson WL 2000,"Are project finance loans different from other syndicated credits?"*Journal of Applied Corporate Finance* 13(1): 75–87.
20. Klein M 1997,"The risk premium for evaluating public projects", *Oxford Review of Economic Policy* 13(4): 29–42.
21. Kong, D, Tiong, RL, Cheah, CY, Permana, A &Ehrlich, M2008, "Assessment of credit risk in project finance", *Journal of Construction Engineering and Management*, 134/11(876): 876-884.
22. Laffont JJ & Tirole J 1993,*A Theory of Incentives in Procurement and Regulation*, Cambridge: MIT Press, USA.
23. Lewis TR & Sappington DE 1995, "Optimal capital structure in agency relationships", *RAND Journal of Economics*: 343–361.
24. Martín, IA, Doussoux, PC, Sambricio, AM, García, VG, García, PY, & Erasun, CR 2012, "Análisis del coste del tratamiento del paciente politraumatizado en un hospital de referencia en España", *Cirugía Española*, 90(9); 564-568.

25. Martimort D&Pouyet J (2006) *Build it or not: Normative and positive theories of public–private partnerships,* mimeo, IDEI Toulouse and Ecole Polytechnique.
26. Martimort D& Sand-Zantman W2006,"Signalling and the design of delegated management contracts for public utilities", *RAND Journal of Economics* 37(4): 763–782.
27. Moszoro M. 2010,*A theory of efficient public–private capital structures*. Mimeo.
28. Ng A & Loosemore M 2007,"Risk allocation in the private provision of public infrastructure", *International Journal of Project Management* 25(1): 66–76.
29. Nikolic, IA & Maikisch, H 2006, *Public-private partnerships and collaboration in the health sector: an overview with case studies from recent European experience*, The International Bank for Reconstruction and Development / The World Bank, Washington, DC.
30. Robinson, J C &Luft, HS 1985, "The impact of hospital market structure on patient volume, average length of stay, and the cost of care", *Journal of Health Economics*, 4(4): 333-356.
31. Schmidt KM 1996,"The costs and benefits of privatization: An incomplete contracts approach". *Journal of Law, Economics, and Organization* 12(1): 1–24.
32. Schwartz G, Corbacho A& Funke K (Eds.) 2008,*Public Investment and Public–Private Partnerships: Addressing Infrastructure Challenges and Managing Fiscal Risks*: Palgrave Macmillan.
33. Sorge, M 2011, "The nature of credit risk in project finance", *BIS Quarterly Review*, December.
34. Sorge, M& Gadanecz, B 2008, "The term structure of credit spreads in project finance", *International Journal of Finance & Economics*, 13(1): 68-81.
35. Williamson OE1975,*Markets and Hierarchies,* New York: Free Press: 26–30.
36. Williamson OE 1985,*The Economic Institutions of Capitalism*. Simon and Schuster, New York: Free Press.

HOW TO CONTROL RISKS? TOWARDS A STRUCTURE OF ENTERPRISE RISK MANAGEMENT PROCESS

Lidia MANDRU
Transilvania University of Brasov,
Faculty of Economic Sciences and Business Administration
Brasov, Romania
lidia.mandru@gmail.com

Abstract: *In this paper, we try to establish a structure of enterprise risk management process highlighting the steps that a company should follow in order to keep occurring risks under control. The reader will find that risk management process involves five basic stages: setting goals, risk identification, risk evaluation, risk response planning and risk monitoring and control. Risk score matrixÂ decision tree and Monte Carlo simulation are some methods presented in this paper and used to qualitatively and quantitatively analyze risks. For the main categories of risks, we bring in some preventive measures that companies may apply to face risks preserving their competitive advantage on market.*
Keywords: *risk evaluation; risk monitoring and control; risk prevention; risk score matrix; Monte Carlo simulation.*

1. INTRODUCTION

The XXth century was marked by a significant increase in the international business, the multitude of factors involved in global economic relations determining a lot of specialists to affirm that nowadays business tend to become increasingly risky. The leadership of a successful organization involves in-depth knowledge of the risks that could intervene in business activities as and of how they may affect the attainment of the objectives established by the organization in question.

What does risk and risk management represents?

Till our days, there have been issued many definitions of risk. For example, in Merriam-Webster's Collegiate Dictionary, Eleventh Edition (Merriam, 2003) risk is defined as follows:

„*1*: possibility of loss or injury;
2: someone or something that creates or suggests a hazard;
3 a: the chance of loss or the perils to the subject matter of an insurance contract; also: the degree of probability of such loss;
b: a person or thing that is a specified hazard to an insurer <a poor risk for insurance>;
c: an insurance hazard from a specified cause or source <war risk>;
4: the chance that an investment (as a stock or commodity) will lose value”.

As we see, the 3a risk definition introduces the probability concept which we shall found to be significant in risk approaching.

According to the Project Management Institute and its Project Management Body of Knowledge Guide, risk management represents a systematic process of identifying, analyzing and responding to risks that may occur in a project. This involves maximizing the results of positive events (opportunities) while minimizing the consequences of bad events within a proactive approach to taking control of risks (PMBOKGuide, 2000).

Risk management has the following characteristic features:

- it represents a continuous process, with a dynamic evolution in time;
- it is specifically under the responsibility of general manager and executive management which have to meet the organization's objectives;
- it is settled into practice through an appropriate strategy with the entire company's staff participation at all hierarchical levels;
- it allows the growth of the activities' effectiveness carried out under conditions of risk and uncertainty.

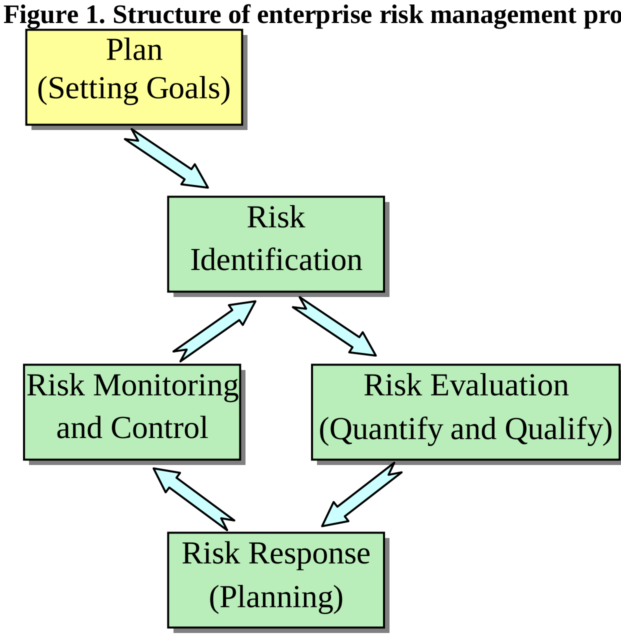
2. FUNDAMENTAL METHODOLOGY

Risk management process involves the following five basic stages (McIsaac, 2008):

- Plan;
- Identify;
- Evaluation (Quantify and Qualify);
- Respond;
- Monitor and Control.

The structure of the process of enterprise risk management can be graphically represented as follows:

Figure 1. Structure of enterprise risk management process



(Source: after Bârsan-Pipu&Popescu, 2003, PMBOK Guide, 2000)

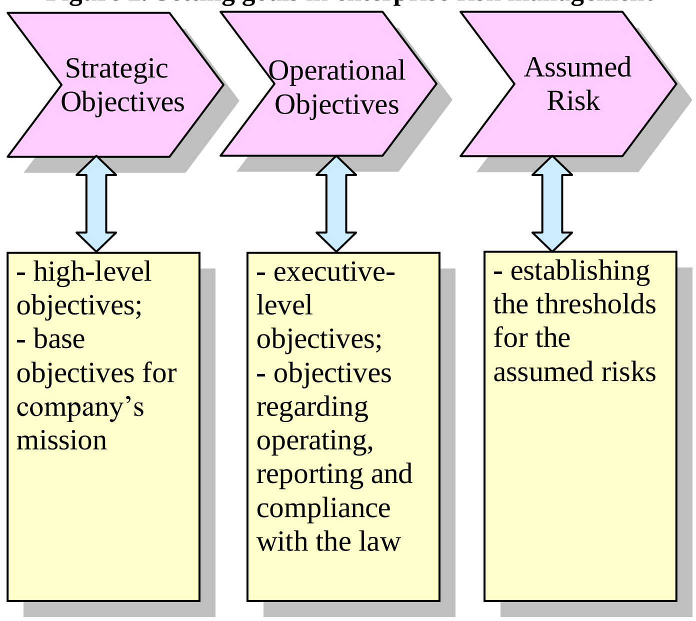
We shall explain in details the five basic stages of risk management process as follows:

A. Plan (Setting Goals)

Before initiating any activities regarding enterprise risk management is necessary to set the organization's goals that must be consistent with its mission but also with the risk quantity, that organization may assume.

Setting goals is a prerequisite for the identification, evaluation and risk response planning having the following structure:

Figure 2. Setting goals in enterprise risk management



(Source: after Friedman&Savage, 1948)

B. Risk Identification

At this stage there are identified the events that could adversely affect the ability of the organization to achieve the settled objectives.

Hazard identification has to be carried out regularly, the organization having to take into account both internal risks (which can be controlled and influenced) and external risks (which are not under the control of the organization).

Risks may be identified by several methods and techniques such as (Bârsan-Pipu&Popescu, 2003) (Cornescu et al., 2004):

- establishing control lists that contain potential sources of risks (e.g. errors and omissions in design and execution, environmental conditions, fluctuation of staff, changes in costs and completion time, etc.);
- applying techniques to collect data: brainstorming, Delphi technique, SWOT analysis;
- use of diagrams: cause-effect diagram, the flow diagram of system or processes, the influence diagrams;

- analysis of the company's archive documents to identify the problems that have arisen in similar situations;
- use of experience of the directly productive staff who often faced risks and problems which the indirectly productive staff did not seize;
- identification of external risks due to changes of laws, of the business climate, etc.

C. Risk Evaluation

Risk evaluation presumes qualitative and quantitative risk analysis.

Qualitative Risk Analysis

To develope this kind of analysis, the estimation of probability and impact of risk has to be determined; depending on the results we shall switch to quantitative risk analysis or to risk response planning.

In practice, there are used many methods and techniques for qualitative risk analysis of which we shall present as follows:

a) probability and impact of risk;
b) risk score matrix.

a) Probability and impact of risk

Risk probability represents the possibility of risk in question to occur. To mitigate risks, organizations have to identify the probability of expected events to occur. (Bârsan-Pipu&Popescu, 2003, Foriş, 2011).

According to *the theory of probabilities*, it is called *the probability* of the event A (designated as P (A)), the ratio between the number m of favorable results for event A to happen and the total number of n results in the experiment, considered equally possible (all results are possible) (Cenuşă, 1999).

$$P(A) = \frac{m}{n} \qquad (1)$$

One of the properties of the probability thus defined is:

$0 \leq P(A) \leq 1$ whatever the event A is, whereas $0 \leq m \leq n$.

For the impossible event m = 0, while for certain event, m = n.

In *statistics*, the occurrence probability P (A) for an event A is determined as follows (Cenuşă, 1999):

$$P(A) = \lim_{n \to \infty} \frac{n(A)}{n} \qquad (2)$$

where n(A) is the occurrences number of the event A in the n independent performed tests.

The *risk impact* indicates the effect that risk has upon the organization's objectives if it manifests.

Events with a potential negative impact represent risks that company must manage while events with a potential positive impact represent **opportunities** through which the company can eliminate or reduce risks.
The probability and impact of risk are rated as "very high", "high", "moderate", "low" or "very low".

b) Risk score matrix

Risk score matrix is based on combining the probability and impact scales (Bârsan-Pipu&Popescu, 2003).

The risk probability scale includes values between 0 and 1 (0 = impossible event; 1 = certain event). A broad scale that is used in this field includes the 0.10, 0.30, 0.50, 0.70 and 0.90 values (0.10 = very unlikely to risk appearance; 0.9 = very likely to risk appearance). The probability scale may also have ordinal values that correspond to the values above: "very unlikely", "unlikely", "medium", "likely" and "very likely".

The scale of risk impact reflects the level of risk impact upon the organization's objectives. This scale can be cardinal including values of 0.05, 0.10, 0.20, 0.40 and 0.80, or it may include ordinal values that correspond to those mentioned above: "very low", "low", "moderate", "high" and "very high".
Risk score is calculated as follows:

$$\text{Risk score} = \text{Probability} \times \text{Impact} \qquad (3)$$

In order to determine the scores corresponding to each risk there has to be established the risk score matrix:

Table 1. Risk score matrix

Probability	Risk Impact				
	0,05	0,10	0,20	0,40	0,80
0,90	0,05	0,09	0,18	0,36	0,72
0,70	0,04	0,07	0,14	0,28	0,56
0,50	0,03	0,05	0,10	0,20	0,40
0,30	0,02	0,03	0,06	0,12	0,24
0,10	0,01	0,01	0,02	0,04	0,08

(Source: Bârsan-Pipu&Popescu, 2003)

Score < 0,05 – low impact (green color);
0,05 ≤ Score < 0,15 – moderat impact (yellow color);
Score ≥ 0,15 – high impact (red color).
Risks having a moderate or high score will be the first subjects for the quantitative analysis.

Quantitative Risk Analysis

Quantitative analysis of risk represents one of the phases that have to be followed in order to evaluate risks that an organization may face while developing its business.

This kind of analysis aims to numerical assessment of the probability and impact of each risk upon the organization's objectives.
For this purpose there are used several quantitative techniques such as the decision tree method and Monte Carlo simulation (Bârsan-Pipu&Popescu, 2003).

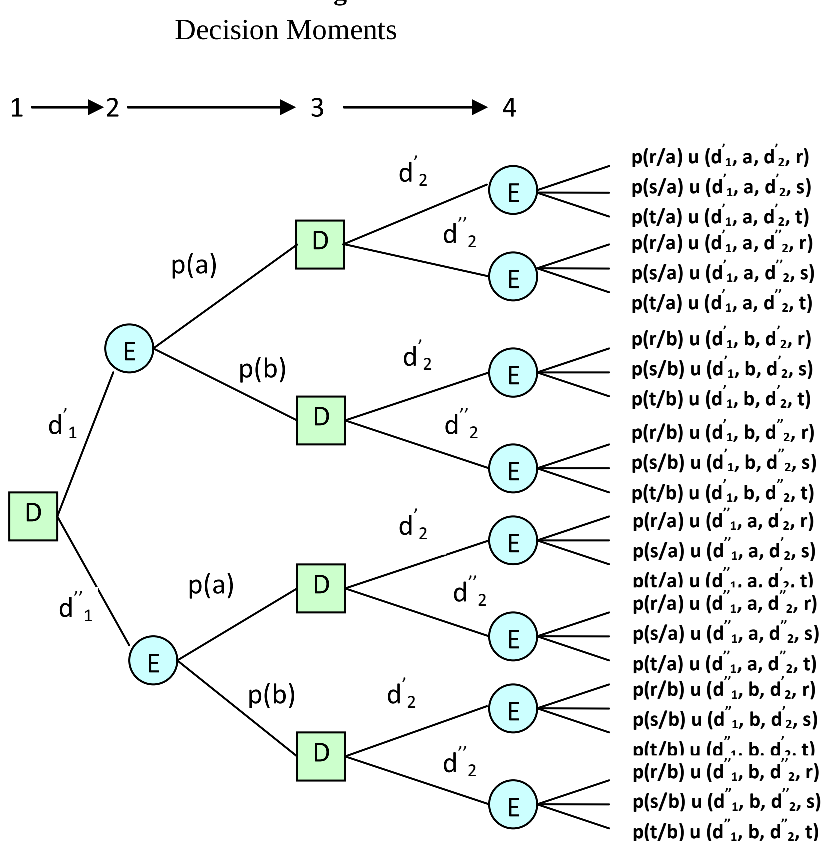
a) The Decision Tree Method

According to Project Management Institute, the decision tree is a diagram that describes the decisions took by the decider and the implications of choosing one or another of the available alternatives. It incorporates probabilities of risks to occur and the costs or rewards (benefits) of each logical path of events and future decisions (Project Management Institute (2000).

By this method, there are represented random events and decisions, as the deciders perceive them.

For each probable future event (represented as a circle) is provided the action (represented as a square) that can be adopted by the decider, resulting a tree structure. Achieving a future event may involve the adoption of one or more paths to follow, the sum of the probabilities for these possible evolutions being equal to one (Dragotă et al., 2003).

Figure 3. Decision Tree



(Source: after Niculescu&Verboncu, 1999)

D – decision point;
E – probable event;
u – profit accordingly to different degrees of uncertainty.

Decisions d’1 and d’’1 are taken in conditions of uncertainty whereas the choice consequences depend on the probable events E from the time 2, events to whom certain occurrence is not known exactly in time 1. Studies provide probabilities p(a) and p(b) for events E (with variants a and b) to occur in time 2.

The sum of probabilities for each branch linked to a decision must be equal to 1:

$$p(a) + p(b) = 1 \quad (4)$$

Regardless of the choice made at this moment, the enterprise management will have to decide secondly in time 3 when it should opt for the decisions d’2 and d’’2. The result of this second decision depends on the event in time 4 whose occurrence is uncertain in time 3. The three final consequences shall be denoted as r, s and t. In case when in time 2, event „a” took place, the probabilities to appear the consequences r, s and t are p(r/a), p(s/a) and p(t/a). If the event „b” occurs, the probabilities will be p(r/b), p(s/b) and p(t/b) (Nicolescu&Verboncu, 1999).

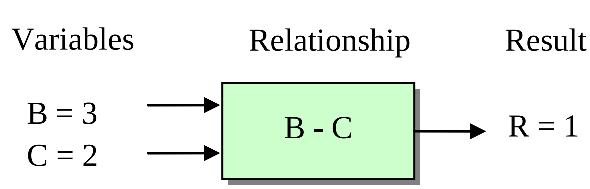
Therefore, applying the decision tree method, the decider may quantitatively evaluate the risk associated with each decision taken in conditions of uncertainty.

a) Monte Carlo Simulation

Monte Carlo simulation represents a technique that performs a project simulation many times in order to calculate a distribution of likely results (Project Management Institute, 2000). By this kind of simulation, risks associated with the events of a system under conditions of uncertainty may be evaluated. Typically, simulation techniques base on the development of a statistics and mathematics forecasting model. Experiments are conducted upon the built model since experimenting on a real model is too expensive or require a long time.

To understand how such a model can be build we shall illustrate a simple one related to investment appraisal and which shows a single relationship between two variables (Savvakis, 1994).

Figure 4. Forecasting model



(Source: Savvakis, 1994)

Where, B = Benefits and C = Costs.

An efficient forecasting model has to include all relevant variables and to exclude all non-relevant ones using the correct relationships between them.

Within these experiments, questions of interest about business environment may get answers; i.e. the simulation model may reveal answers to ”what if” questions (the so-called sensitivity analysis) (Kleijnen, 2004).

To perform a simulation experiment, the following steps have to be taken (Bârsan-Pipu&Popescu, 2003):

- identify the problem which shall be the subject of experiment;
- collect and process the primary data;
- build the simulation model;
- estimate the parameters for the analyzed system;
- evaluate the system performances and test the parameters;
- build the simulation algorithm;
- validate the simulation algorithm;
- plan and perform the simulation experiment;
- analyze the data resulted from simulation;
- take the decision regarding the analyzed system.

Applying Monte Carlo simulation before any real expenses offers the possibility not to incur substantial investment of human and financial resources until the preliminary risk profile of the projects seems to be acceptable. This kind of simulation provides the necessary information that makes possible a more efficient allocation of resources and management of risk within the enterprise.

Nevertheless, there are cases within the costs of risk analysis can be higher than the expected benefit likely to result with the help of this investigation and then such expense is not justified (Savvakis, 1994). It is up to top management to decide which kind of expense to afford and which not.

D. Risk Response Planning

There are several strategies for risk response and for each risk will be selected the strategy which is most likely to be effective. A main strategy and a backup strategy are selected of the following:

a) Avoiding risk:

- Can be achieved by: abandoning or reengineering the activities flow that lead to risk increasing, allocation of additional time and resources, adoption of a conventional know how instead of another one which has not been tested yet, etc.

b) Risk transfer:

- it presumes to transfer the risk impact to a third party including the liability of risk response;

- this strategy is most appropriate when company is exposed at a financial risk; in this case, the risk transfer may be carried through assurances, letters of credit, hedging operations (futures and forwards contracts, swaps, etc.).

c) Decreasing risk:

- the aim of this strategy is to decrease the probability of risk occurrence and / or the risk impact bellow an acceptable threshold;
- risk decreasing can be achieved by implementing a new means of actions to reduce risk such as adopting less complex processes, conducting additional tests, etc.

d) Risk approach:

Risk may be approached in an actively or passively way.

Active approach of risk involves the establishing a backup plan to be put into practice when the risk occurs; through this plan it can be significantly reduced the cost of the necessary measures to counteract the negative impact of risk.

Passive approach of risk is when the organization does not apply to measures to counteract the risk before its occurrence, preferring to approach risks as they occur (Bârsan-Pipu&Popescu, 2003).

E. Risk Monitoring and Control

Monitoring focuses on the status of risks while checking the actions taken to mitigate them.

Controlling risk presumes to correct the deflections from the planned response actions to risk and to improve the processes of risk management.

Risks monitoring and control have to perform permanently throughout the life cycle of a company.

The purpose of risk monitoring and control is to determine whether:

- risk responses have been implemented as planned;
- the effectiveness of the response actions is the expected one or there have to be established new responses to risk;
- the organization risk exposure has changed in comparison with previous situation;
- there is a signal of risk occurrence;
- the identified risks have already occurred or risks that had not been initially identified manifest.

In practice, there are used several *instruments and techniques for risk monitoring and control* such us:

a) Checking lists

Checking lists used to identify risks can be used in risk monitoring and control. Particular attention should be drawn to risks that do not appear on risk identification standard lists.

b) Risk audits

The risk auditors have to examine the effectiveness of risk response plans regarding risk prevention, risk decrease or risk transfer. These audits should be conducted throughout the lifecycle of the company.

c) Periodical reviews of the organization's risks

Periodical reviews of the organization's risks have to be carried out, whereas the priority of risks may change over time and that requires additional qualitative and quantitative analysis for risks in question.

d) Analysis of results

To monitor the general performances of the organization we shall compare the obtained results with those originally set out and there can be found some deflections. In this case are followed again the stages of risk identification, evaluation and response.

e) Additional risk response planning

When unidentified risk occurs or when the impact of a risk is bigger than expected then it is possible that the planned response was not adequate. In this case it is necessary to plan a further response to risk, identifying new techniques and strategies to prevent risks, to mitigate their impact or transfer them to a third party (Bârsan-Pipu&Popescu, 2003).

3. RISK PREVENTION STRATEGIES

Some research studies has shown that Romanians like the Latin and Balkan nations manifests a high level of uncertainty avoidance and they permanently try to influence and control the future (Nicolau&Foriș, 2012). Fast changes affect the global economy generating additional risks that companies confront with, managers finding themselves in a position to discover new formulas to maintain a balance between exercising their authority and controlling new forms of risks.

Simple reaction to this variation of company's specific risks is not sufficient for an effective risk management. Such a relatively passive attitude of taking into account the risks and their potential impact upon the organization have to be accompanied by a strategy to anticipate and prevent risks, through the implementation of such effective processes that help the company to identify, measure and finally control risks in a pro-active manner (Horobeț, 2005).

To protect organizations against risks, managers may apply several measures that depend on the nature of risk (we shall approach the main risk categories):

Table 2. Risk prevention measures

Nature of Risk	Preventive Measures
Economic risk	- contracting insurance policies; - inclusion in contracts of appropriate clauses such as those that would cover the risk that the partner will not respect the engagements specified by contract; - establishment of accounting provisions (reserves); - carrying out investigations on the insolvency of potential customers before signing contracts.
The risk of bankruptcy	- establishment of a financial reserve known as the working capital; - reduce receivables; - replace the inefficient managers; - establishing a strong centralized financial control; - establishing new payment terms and restructuring debts through agreements with creditors (e.g.: banks, suppliers).
The price risk	-inclusion in contracts of protective clauses such as: clause of price indexing, clause

	of price revisal, etc; - applying to futures contracts (practicing hedging operations), contracts with options (Call and Put).
Operational risk	- implementing a quality management system; - readjustment of the production process so that products can be quickly adapted to the new requirements of customers; - building a favorable environment for the development of inventions and innovations.
Selling risk	- inclusion of penal clauses in the contract; - require dubitable customers to present a letter of credit; when it comes about credit sales, organizations may apply to artificial neural networks that have been proved to be accurate tools for credit scoring and risk analysis (Khashman, 2011); - require the auction participants to consign on the auction organizer's account an amount of money as guarantee that will be lost if they give up the conclusion of the contract.

Along its development, the company will establish multiple risk prevention strategies integrated into a global competitive one that will make possible the significant reduction of risks that are inherent to any company, in any field of activity. Choosing a particular strategy will primarily aim to preserve organization's competitive advantage, ensuring the viability of its internal and international affairs.

According to some authors (O'Brien, 2006), to make the optimal decision about risk management in the real practice, the organization must compare the deadweight costs of not managing risk with those associated with each risk management approach. The organization will adopt a strategy that will maximize the added value taking into account that correlations between different types of risks which is essential in measuring company`s wide risk (Nocco&Stulz, 2006).

In order to prevent risks that may occure in their performed activites, organizations may also apply Kaizen Synergy Risk Programmes (KSRP) based on Kaizen strategy concept established by Masaaki Imai, the founder of Kaizen Institute, a global organization that operates in Europe, Asia, America, Africa and Australia (Mândru&Păuna, 2012). Implementing KSRP, organizations may have a better control upon risks, improving workplace safety and business performance as a result of (KaizenSynergy, 2016):

- more efficient reporting systems;
- identification of potential risks;
- appropriate management of potential risks;
- providing adequate information to managers and board members and
- reviewing processes to minimise the occurence of identified risks in the future.

With regard to help organizations to efficiently face risks, there is also a major need of understanding risks in a systemic way, at national level looking forward to forecast their major implications upon organizations activities (Dăianu, 2009, Suciu, 2012).

4. CONCLUSIONS

Implementing risk management in an organization is a challenge and it presumes that employees at all levels must clearly understand the role of this kind of management and its skill to create value. Through risk management, an organization is able to understand measure and manage its overall risk in order to maximize the organization's value to its stakeholders. When it comes about increasing the value amount of the capital, then if capital is the constraint it means that for a given level of capital there is an optimal level of risk that managers may assume.

To sum up, we say that in this paper we analyzed how an organization can control the range of risks that it may be exposed to. We examined how the process of risk management can be implemented within organizations, providing the structure of investigating risks in detail. Furthermore, we had build up an overview of the risk management process which can be adopted by any organization. We want to highlight that risks should not be approached individually, separating one from each other: managers should have a holistic view of risks. Therefore, we may say that companies can manage risks in two different ways: they can manage one risk at a time, individually or they can holistically manage all the risks that may occur in their activities applying the risk management process at the enterprise level. Companies that follow the holistic approach will benefit of a long-term competitive advantage that will lead them to business success.

References

[1] Bârsan-Pipu N, Popescu I. (2003). *Risk Management: Concepts, Methods, Applications*, Brasov, Transilvania University Publishing House, ISBN 973-635-180-7, pp. 137-157

[2] Cornescu V, Curteanu D, Marinescu P, Toma S. (2004.) *Management from Theory to Practice.* Bucharest, University of Bucharest Publishing House, ISBN 973-575-831-8, pp.56-60

[3] Cenuşă G. (1999). *Probability Theory and Mathematical Statistics*. Bucharest, Academy of Economic Sciences Publishing House, ISBN 973-9462-18-9, pp.3-14

[4] Dăianu, D. (2009). *Whither capitalism? The Economic Crisis, Ideas, Institutions.* Iași, Polirom Publishing House, pp. 172-173

[5] Dragotă V. et al. (2003). *Financial Management.* Bucharest, Economic Publishing, Vol.1, ISBN 973-590-841-7, pp. 262-275

[6] Foriș T. (2011). *Human Resources Management.* Brașov, Transilvania University Publishing House, ISBN 978-973-598-837-1, pp.93-95

[7] Nicolau C., Foriș T. (2012). Romanian Political and Moral Crisis. Background of Business Stategic Development. *Ovidius University Annals, Economic Sciences Series*, Volume XII, Issue 2, pp.865-867

[8] Friedman M, Savage L. (1948). The Utility Analysis of Choices Involving Risk. University of Chicago Press, *Journal of Political Economy*, Vol. 56, No.4

[9] Horobeț A. (2005). *Risk Management in International Investment.* Bucharest, ALL Beck Publishing House, ISBN 973-655-682-4, pp.72-79, 207-237

[10] Khashman A. (2011). Credit Risk Evaluation Using Neural Networks: Emotional Versus Conventional Models. *Journal of Applied Soft Computing*, Elsevier, Vol. 11, No. 8, pp.5477 - 5484.

[11] Kleijnen J.P.C. (2004). *Design and Analysis of Monte Carlo Experiments.* Tilburg University, Center Discussion Paper No. 17, ISSN 0924-7815, pp.2-6

[12] Mândru L., Păuna D. (2012). Application of Small Steps Strategy in the Management of European

Companies. Ebsco, *Acta Universitatis Danubius Oeconomica Journal*, Vol.8, no.3, Print ISSN 2065-0175, Online ISSN 2067-340X, pp.40-46,

[13] McIsaac K. (2008). *Projects Represent Risky Business.* N. Carolina, USA Project Managers Inc., pp.1-4.

[14] Merriam - Webster's Collegiate Dictionary, Eleventh Edition. (2003). Springfield, USA, ISBN-10: 0877798095, ISBN-13: 9780877798095. Available at http://www.merriam-webster.com/dictionary/risk

[15] Nicolescu O, Verboncu I. (1999). *Management.* Bucharest, Economic Publishing House, ISBN 973-590-164-1, pp.219-232

[16] Nocco B W, Stulz R M. (2006). *Enterprise Risk Management: Theory and Practice*. New York, July, pp.2-7, 22-29

[17] O'Brien T. J. (2006). Risk Management and the Cost of Capital for Operating Assets. *Journal of Applied Corporate Finance,* pp. 9-10

[18] Project Management Institute (2000). *A Guide to The Project Management Body of Knowledge*. PMBOK Guide, USA, ISBN 1-880410-25-7, pp.127-144

[19] Savvakis S. C. (1994). Risk Analysis in Investment Appraisal. *Project Appraisal Journal*, Vol. 9, No. 1, New York, pp. 2-6, 23-27

[20] Suciu T. (2012). Financial Innovations and the Actual Crisis. *Ovidius University Annals, Economic Sciences Series*, Volume XII, Issue 2, pp.530-535

[21] KaizenSynergy (2016). Retrieved from http://www.kaizensynergy.com/risk-management.php

CONTENT ANALYSIS OF CEO STATEMENT AND AUDITOR`S RECOMMENDATION: A CASE STUDY OF BANCA TRANSILVANIA

Paula-Andreea TERINTE
Faculty of Economics and Business Administration
"Alexandru Ioan Cuza" University
Iași, Romania
paula.terinte@yahoo.ro

***Abstract**: The aim of this paper is to determine if recommendations of auditors are implemented by the management and are described in the CEO statements and if they have the same purpose, namely, extending the performance of the bank. The study provides important information on the quality of audit performed in Romania of a bank that is an independent bank holding the majority Romanian stake and investigates the relationship between internal audit and the bank`s management. We conducted a content analysis of 6 annual independent auditors` reports and 5 annual CEO statements of Banca Transilvania using emergent coding. For our analysis, we retrieved data from the Annual Reports of Banca Transilvania for the period between 2008 and 2013. The results were significant; the management of the bank takes into consideration auditors' recommendations and implements them, which validates our research question. After implementing the recommendations of auditors in 2009 and 2010, CEO statements present positive financial results of the bank. The study found out that the analysed reports have a very specific structure.*
***Keywords**: Internal Audit, Performance, Bank, Management*
***JEL Classifications**: G21, M42*

INTRODUCTION

Audit is generally viewed as a manifestation of accuracy control and analysis of financial performance by means of accounts and summaries of accounting.

Internal audit has been highly researched in scientific papers, articles and studies in the literature both nationally and internationally, although content analysis has not been extensively used for areas, such as risk management, human and financial resources. Internal audit and risk management have the same aim that of risk control. The main limitation of internal audit compared to risk management is risk taking. Risk management is the main manifestation and consideration of risks faced by an entity and taking action needed to quantify them. Internal audit may provide guidance to companies in terms of risk management of financial risks or even clearly identify all financial risks affecting the company.

Internal audit practice has its roots in international business that were later applied to national enterprise practice and banking. Internal audit has now expanded to all types of organizations operating regardless of their field of activity.

Auditing plays a very important role in supporting in general the efficient reporting of a company. Bank directors are responsible for the information in the annual reports and the information of auditor's reports. Internal Audit provides an independent and objective opinion for the management of the company in terms of maintaining acceptable risk levels of the organization and by that increasing its performance.

This paper provides valuable information on the quality of the audit performed in one Romanian bank, which is an independent bank that holds the majority Romanian stake, and describes the relationship between internal audit and the banks management.

The reminder of this paper is organized as follows: Section 2 presents the literature review, Section 3 provides methodology and data used in our study, Section 4 provides results and discussions of the analysis and in Section 5 provides the conclusions.

LITERATURE REVIEW

Internal audit has been extensively researched in numerous scientific papers, articles and studies in the literature both nationally and internationally. It has been found that internal audit leads to new responsibilities and provide the path to building new objectives in risk management. Internal audit contributes to management efficiency of corporate risk leading to its increased performance but it cannot be achieved without effective management of collaboration and support of the views and recommendations of the internal audit.

The role of risk management is not to eliminate risk as this would mean to eliminate the reward, the role is to manage risk so you know where to invest and where not (Jorion P., 2007 p. XIX).Internal audit is an objective and independent form of assessing activities within an entity organized as a service (Joel M., et.al, 2010).

There are numerous research studies carried out in the field that examines the implications of internal audit and corporative risk management. A first analysis conducted in 5 large companies: FirstEnergy Corporation, General Motors, Unocal, WalMart, Accurately and Canada Post Corporation highlights the implications of internal audit in risk management. Internal audit is a key element in risk management of each company but it manifests itself differently from company to company. Taken as a whole, it has the internal audit and risk management implications (Walker L., et.al. 2002:15), as follows:

- Helps to identify risks;
- Facilitates risk identification workshops;
- Integrates information and workshops;
- Helps develop risk management process and risk reports.

Internal audit plays an important role in risk management and strategy of each company. Besides this approach at the enterprise level, there are studies with analysis of the overall impact of the internal audit and corporative risk management. Based on an analysis of the questionnaire given to audit directors of the Institute of Internal Auditors in 122 organizations from different countries, it found that there is a greater exposure of the implication of the internal audit in risk management on the banking sector and education. Internal audit helps to open up new goals or completing objectives in view of the risk management that lead to new contributions and additional responsibilities. (Beasley S.M.,et.al, 2006).

Between internal audit and performance of a company there is a strong link resulting in increased company value and goals (Caratas M., Spatariu E., 2014).

The collaboration between internal audit and risk management leads to increased company performance and its value as these identify critical internal audit risks and report them to the existing risk management department. Other studies found that, if internal audit collaborates with risk management, then, the resource allocation is more efficient and improves communication with the company management offering a clearer image on existing and possible risks of the company in its activity (Egerdahl R., et al. 2012).Moreover, implementation of internal audit in conjunction with risk management leads to more efficient risk management of the company (Dima F.C., 2013).

Between internal audit and company performance there is a strong link that results in increased company value and goals. By fulfilling its role of evaluating the effectiveness of internal control and risk management, internal audit contributes directly to minimizing risk in financial reporting (Caratas M.A, Spatariu E.C, 2014).The internal audit acts as a guide leading to risk management performance of companies (Ducu C., 2013).

The objectives of internal audit vary from one company to another but in all companies internal audit department aims to improve risk management, internal control and performance. There are a number of ways in which internal audit risk management can help a company without affecting its independent or internal audit objectives (Dăneci-Patrice D., et.al. 2014):

- Organizing risk management workshops for staff;
- Expertise audit team members may provide risk management solutions;
- Ensuring risk management assessment and recommendations made by the department.

Chartered Institute of Internal Auditors (2014) in "Risk based internal auditing - RBIA" defined a methodology for getting in touch with the general structure of internal audit risk management organization. Risk-based internal auditing allows internal audit to inform the management on the efficient risk management in a company. This paper examines the advantages of RBIA and how it could be implemented.

Historically, a decrease in efficiency of audit-based control was noted in China. Risk-based auditing was introduced due to the need of protecting businesses against the risk of fraud, forgery or lacks the financial statements declaration consistent with the reality of company financial statements. In 2007, risk-based audit was introduced that requires auditors to be familiar with corporate governance of the company that they audit and to identify irregularities in the company's financial situation that lead to efficient risk management (Cao L., et.al. 2015).

Internal audit can also serve to prevent or detect fraud within a company. Internal audit can be viewed as assistance aimed to improve risk management and implement company'sgoals with added value (Petrescu D., Tieanu A., 2014). The companies that have a periodic internal audit manage to streamline risk management objectives and achieve medium and long-term added value.

Moreover, increasing the performance of a company and therefore maximizing profits, streamline risk management and reduction of costs for achieving objectives in the medium and long-term represents a condition for the existence of internal audit and control in collaboration and communication whit risk management (Petrascu D., Tamas A., 2013).

The study of (Zona, 2013) analyses the evolutionary perspective of Italian firms based on board leadership structure and diversity of CEO's time in office suggested that "CEO objective and interest change over time and that board roles should shift accordingly, from CEO leadership development during the early stages of CEO time in office toward monitoring during the latest stages". The study analyses the impact on innovation investment in Italian firms of the board leadership, the board structure and diversity and the board characteristics. In this study, the agency theory is used and it states that in Italy the effects of board independence are dependent on CEO's time in office.

It should be noted that the quality of a report, especially an auditors`report, is the main instrument in our study. In a recent study (Kabiru, 2013), the quality of auditors` reports in the Nigerian Banking Industry was analysed and the researcher discovered that the quality of the auditors` report plays a great role in the assessment of a bank`s performance and that auditors` provide useful information on internal control fragility to the management. In Nigeria, the auditors` report has an impact on bank's performance and agrees with (Millichamp, 1996) that auditor`s report influences banking performance, therefore a good auditor report should be encouraged.

The association between corporate accountability report and corporate reputation (Craiga R.J., 2012) was made by analysing content of CEO letters of 23 US firms with high reputation and content of CEO letters of 23 US firms having low reputation. The results were abnormal and highlighted the need of caution in estimating statements about the effects on corporate reputation of the language choice in corporate annual reports. The result showed that the size and the visibility can be positively influenced only where corporate reputation is associated with the language choice made in CEO letters.

An analysis of the influence of audit committee on voluntary ethics disclosures using content analysis of company`s annual report suggests that only the tenure and multiple directorships audit characteristics are significant in the voluntary ethics disclosure (Rohana O., 2014). The study analyses 94 companies of Bursa Malaysia and deals with stakeholders by suggesting that they need to highlight the ethics disclosure of companies before audit committees.

An analysis of 42 interviews of internal auditors that work in public administration in Quebec suggests that "internal auditing is not the governance watchdog expected by the regulatory bodies" (Roussy M., 2013), the author implies that internal audit holds a protector and helper role. The internal auditors believe that their main role is to serve the top management and the company.

A very interesting content analysis related to reputation was conducted in 2010 (Hooghiemstra R., 2010), in which 50 CEO letters of 50 Japanese companies and 50 CEO letters of U.S. companies were analysed. The study investigated whether the CEO letters explain the causes of positive and negative news of the company. The results were that the CEO letters to the shareholders in U.S companies emphasize positive news, the U.S. and Japanese CEO letters are statistically identical regarding the fact that CEOs claim responsibility for positive news and Japanese CEO letters tend to avoid more CEOs responsibility for the negative news (Hooghiemstra R., 2010).

The effectiveness of auditor's report affects the judgments of loan officers (Schneider A., 2008). The study analysed data from 111 bank loan officers and it found that that the probability of extending a line of credit of a company is diminished when the company has an unfavourable internal control opinion compared to the unqualified one. The auditor's reports influence the bank when it extends a loan or rejects the request.

METHODOLOGY AND DATA

The content analysis represents a systematic and replicable technique that compresses numerous words of text into categories that are based on explicit rules of coding (Stemler S., 2001).We conducted a content analysis of 6 annual independent auditors` reports and 5 annual CEO statements using emergent coding, categories are established following some preliminary examination of data (Haney, et.al. 1998).

We analysed the Chairman and CEO statements and independent auditor`s reports from the Annual Reports of Banca Transilvania during 2008-2013. We selected Banca Transilvania for our analysis due to bank's specific features, such as bank's independence, it is not a subsidiary and it is not included in an international group and the audit and CEO statements refer only to Romanian business environment and the bank holds majority Romanian-owned stake thus being the only bank of this kind.

The chosen period of time period of time is up to 2013 as the Annual Reports of 2014 and 2015 are still not available for the public view.

The content analysis aimed to answer following questions:

Are audit recommendations considered and implemented by the bank`s management?

Are audit recommendations ignored by the bank`s management?

The independent auditors` report of Banca Transilvania is targeted at shareholders` of the bank. The reports are divided into 7 sections, as follows:

Section 1: Report on the consolidated financial statements;

Section 2: Management`s responsibility for the consolidated statements;

Section 3: Auditor`s responsibility;

Section 4: Opinion;

Section 5: Emphasis of matters;

Section 6: Other matters;

Section 7: Report on conformity of the administrators` report whit the consolidated financial statements.

After analysing the independent auditors` report of Banca Transilvania, we reached an interesting conclusion that there are 6 sections in the report that are identical, only few words are changed, the meaning of the sentence remaining the same. For example, in the independent auditors` report of 2008 in section Auditors` responsibility, they present *" the procedures selected depend on the auditor`s professional judgment…"* and in the independent auditors` reports of 2009, 2010, 2011, 2012 and 2013 in the section Auditors` responsibility, the sentence is changed into *"the procedures selected depend on our judgment…"*then continues an identical content every year. Another modification in 2008 and 2009 reports in section 2 was found: Management`s responsibility for the consolidated statements, they presented:*"The Bank's management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as endorsed by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances"* and in 2010, 2011, 2012 and 2013 in the same section, they presented: *"Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as endorsed by the European Union, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error."*

It seems that in these sections the only modification that the auditors have made is to shorten the sentence. Thus, the sections can be categorized in one category:

Category 1: "Basic sections of legal responsibility needed to be fulfilled by both parts."

Basic sections of legal responsibility needed to be completed by both parts of the category includes: Section 1: Report on the consolidated financial statements; Section 2: Management`s responsibility for the consolidated statements; Section 3: Auditor`s responsibility; Section 4: Opinion; Section 6: Other matters and Section 7: Report on conformity of the administrators` report whit the consolidated financial statements.

Key words of Category 1: Basic sections of legal responsibility needed to be completed by both parts: consolidated financial statements; bank`s management responsibility and auditor`s responsibility, law, ethical requirements, procedures, internal control, auditor, opinion, performing, plan, misstatements, fairly, all material, International Financial Reporting Standards, financial performance, cash-flow, evaluating, accounting principles, procedures, accounting estimates, management, effectiveness, present fairly, report, made solely to the bank, as a body, responsibility, shareholders, law, state to the bank`s shareholders, auditor`s report, no other purpose, opinions, formed, do not accept responsibility to anyone other, administrators` report, not a part of financial consolidate statements.

These sections are identical in the auditors` report regarding the message delivered during 2008-2013 and they highlight in Section 1: Report on the consolidated financial statements, Section 2: Management`s responsibility for the consolidated statements and Section 3: Auditor`s responsibility, the responsibility of the auditors and the responsibility of the bank regarding the auditor according to Standards on Auditing by the Romanian Chamber of Financial Auditors. The standards require that the auditor comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether consolidated financial statements are free of material misstatement and not for making recommendations of the effectiveness of the internal control of the bank.

In Section 6: Other matters, auditors present the legal responsibility that they have for the bank and the shareholders and no one else. In Section 7: Report on conformity of the administrators` report with the consolidated financial statements, in all of the auditors` reports analyzed from 2008 to 2013, the Order of the National Bank of Romania that changes every two years is presented stipulating that they are obligated to read administrators` report and they found in every report from 2008 to 2013 that there is no financial information presented and therefore the administrator`s report is not a part of the consolidated financial statements of the Bank.

Section 5: Emphasis of matters of the independent auditors` report reveals some content modifications in 2008 and 2009. The section is identical between 2010 and 2013, as follows: *"Without qualifying our opinion, we draw attention to the fact that as presented in Note 2c to the consolidated financial statements, the Group has presented in Euros for the convenience of readers the amounts reported in Lei in the consolidated balance sheet and in the consolidated income statement. This presentation does not form a part of the audited consolidated financial statements."*

It seems that from the perspective of the independent auditors` reports in years 2010 through 2013, the only recommendation they can give is one that "does not form a part of the audited consolidated financial statement". This makes us conclude with 3 questions:

1: Does the bank have an extremely efficient internal control and do auditors have nothing to recommend?

2: Are the real recommendations not transparent for the public and are these discussed inside the Bank?

3: Is the auditing performed for the bank at a very low level?

In order to verify this hypothesis, we must further extend our analysis. In Section 5: Emphasis of matters of the independent auditors` report reveals some content modification in 2008 and 2009.

The key words in this section for 2008 and 2009 are: estimated, impairment loss provisions from loans, could be revised, advances to customers, net lease investments, consolidated financial statements, inherent limitations, uncertainties, financial market, assets valuation, internal methodologies developed, applied, consolidated balance sheet, consolidated income statement, local, international, audited financial statements, convenience of readers, the amounts reported in lei, draw attention, after, the approval, euros, lei, convenience.

After analysing the key word, we came to conclusion that we can categorize this section in 2 categories, as follow:

Category 2: Recommendations for Banca Transilvania

Key words: estimated, impairment loss provisions from loans, could be revised, advances to customers, net lease investments, consolidated financial statements, inherent limitations, uncertainties, financial market, assets valuation, internal methodologies developed, applied, local, international, audited financial statements, draw attention, after the approval.

Category 3: Observations that does not form part of the audited financial statements

Key words: consolidated balance sheet, consolidated income statement, reported in lei, presented in Euros, convenience, readers, the amounts.

In Category 2: Recommendations for Banca Transilvania, the auditors` report of 2008 recommended that the bank should revise the estimated impairment loss provision for loans, the advances to customers and net lease investment based on the internal methodologies developed after the date of the approval of the consolidated financial statements. This recommendation is made due the uncertainties on the local and international financial markets regarding assets valuation and to inherent limitation mentioned by the bank. In the auditors` report of 2009, the recommendations were focused on the limitation regarding the operating environment and assets valuation in the financial statements.

In Category 3: Observations that does not form part of the audited financial statements, auditors make the observation that the bank reported in lei the consolidated balance sheet and income statement and the Group presents in Euros the financial statements mentioned for the convenience of the readers.

We conducted a content analysis of the annual Chairman and CEO statements from 2009 to 2013 of Transilvania Bank and categorized every statement, as follows:

The Chairman and CEO statement of 2009:

Category 1: Business environment

Key words: challenging, business environment, uncertainties, unsettled economic environment, future economic deterioration, crisis

It justifies the bank`s strategy by referring to the uncertain business environment and it highlights the top bank position in the business environment.

The CEO and Chairman of Banca Transilvania specify that the business environment is uncertain, challenging, lacking confidence from the economic and political views but the bank has confidence that it will overcome all of challenges of the business environment

Category 2: Strategies and perspectives of the bank

Key words: liquidity, remain, comfortable, level, loan to deposit ratio, profit, higher, strong position, cost-income ratio, improved, raised, deposits, capital requirements, high standards, improved cash-flow, reduced operational costs.

For the year 2009, the financial results of the bank were at a good level. In 2009, CEO statement refers more to new projects and is implementing according to auditors` report the recommendations made by the audit justifying every modification that the bank has made and needs to make in the year to come.

Category 3: Implementing the audit recommendation:

Key words: implemented, coherent and aggressive provisioning policy, loan loss provisions, protective measures, loan portfolio, adapt, flexibility, costumer facing solutions, adapt, reinforcing, new products, investment, customers, strategies, needed, reconsidered, reviewed

The CEO implements the auditor`s recommendations regarding the estimated impairment loss provision for loans, the advice to customer and the net lease investments based on the internal methodologies developed that may be revised after the date of the approval of the consolidated financial statements.

The auditors specify that the recommendations are made based on the uncertainties on the local and international financial markets regarding assets valuation and because of the inherent limitation mentioned by the bank.
For the net lease investment, BT has implemented a platform that provides the customers with advice and co-financing for business turnover or new investment projects.
Category 4: Gratitude
Key words: financial support from EU, structural funds, clients, EBRD, shareholders, professional team players, partners, loyal customers, new shareholder, IFC and Bank of Cyprus. In this category, the CEO expresses the gratitude for all shareholders, partners and teams and introduces new shareholders.
Category 5: Personal image of the bank
Key words: courage, cautious, intelligence, responsibility, relying, professional team players

The CEO has a very good personal image specifying their courage, intelligence, professionalism and responsible spirit.

The Chairman and CEO statement of 2010
Category 1: Business environment
Key words: Romania, business environment, economic, political, uncertainties, market, challenges, capture business opportunities, Romanian economy, economic contraction, recover, tougher competition

In this category, the CEO presents the economic environment, in which the bank operates as an introduction of changes aimed to reinforce the bank`s mission by providing solutions for clients. The CEO is more positive about the business environment than he was in the 2009 statement.

Regarding the business environment, the CEO in his statement of 2010, is certain that in 2011 there will be significant growth as the Romanian economy is expected to recover. Therefore, he is confident about the future positive results of the bank.
Category 2: Implementing the audit recommendation:
Key words: fundamental services, advisory services, clients, expand, balance sheet, operation, providing, improved net interest income, improve, operational program

The solutions represented under category 1 for 2010 are based on the auditors` recommendations regarding the supply of funds, cash management and advisory services. The CEO mentions the improvement of the operational program that is in the auditors` recommendations that conducted to a positive result in 2010. Thus, the auditors' recommendations lead to a positive financial result.
Category 3: Negative financial results:
Key words: although, tougher competition reduced, average margins, corporate loan portfolio

The CEO mentions the negative results in a manner that is justified by the economic environment by avoiding responsibility of the management for the negative financial results.
Category 4: Positive financial result:
Key words: expand, balance sheet, operational performance, top 5 banks, top 3 card issues, and significantly higher figures, will continue, improved net interest income,

operating profit, increased, gross profit, more, operational efficiently, retail loans, grew, contribution, clients, own progress.

In the 2010 statement, the CEO is very pleased with the financial results of the bank and he explains its growth. He also presents the contributions of the bank to its clients and discusses its achievements.

Category 5: Personal image of the bank

Key words: mature team, active players, sustaining the economic well-being, strong capital based, diverse, range of services

In 2010 statement, the CEO has a very positive opinion about the bank and the bank's team. He considers that the bank's team active players sustainits economic well-being.

Category 6: Gratitude

Key words: thanks, shareholders, clients, business partners, trust, on-going support, cooperation, team, recognition, devotion, ambitious work, National Guarantee Fund for SME loans.

In this category, the CEO expresses gratitude to clients, partners, teams and shareholders.

The Chairman and CEO statement of 2011

Category 1: Positive financial results

Key words: experienced, growth, assets, loans, deposits, operations, positive history, well- defined strategy, growth potential, performance, own prosperity, success of our clients and partners, client portfolio, staff, new units.

In this category, the CEO mentions a history of positive financial results of the bank, without specifying the period of time of the growth. The positive results refer to the financial statements of the bank over the years and the client portfolio, staff and the opening of new units. There is no specification to growth in terms of results of financial statements for this year.

In 2009, 2010 he was very proud of the financial results of the bank specifying every positive result and justifying the result and in 2011 he mention only vaguely the history of growth.

Category 2: Strategies and perspectives of the bank

Key words: extensive organic growth, intensive organic growth, confidence, economic development, confirmed, preserve a defensive attitude, risk, keep our identity, targeting sectors, right experience, traditional business model, financial stability, efficiently, long term, shall do our best, active, profitable, player, steadiness, coherence, undertakings

The CEO presents the perspectives of the bank in the years to come. He specifies that the bank will switch from extensive organic growth to intensive organic growth which depends on increasing added value. He approaches a defensive attitude of the bank in maintaining the position held currently by the bank, avoiding risk "targeting sectors where we have the right experience"(CEO statement 2011, p.2) and promoting a traditional business model.

The CEO states that the bank will be more precautious: " we shall do our best to remain a "living body" in the Romanian economic landscape, an active profitable player and last but not least, a brad acknowledged for the quality, steadiness and coherence of its undertakings""(CEO statement 2011, p.2)

Category 3: Gratitude

Key words: thanks, shareholders, clients, business partners, trust, on-going support, cooperation, team, confidence, support

In this category, the CEO expresses gratitude to clients, partners, teams, and shareholders.

The CEO statement in 2011 is based more on the history of the positive financial results of the bank and the perspective of the bank pointing out that the back will adopt a more defensive approach.

The Chairman and CEO statement of 2012

Category 1: Business environment

Key words: dominated, uncertainty, lack of confidence, globally, Romanian business environment, supporting, "business as usual"

In this category, the CEO presents the business environment as uncertain and lack of confidence not only in Romania but globally and that the Bank will carry on supporting this environment.

Category 2: Strategies and perspectives of the bank

Key words: applying, conservative, risk management policies, strong liquidity positions, robust provisioning levels, goals, growing profitability, growing market share, defending top position, reality adapted products, optimizing our business model, increasing efficiency, all levels, financial stability, help clients, financial tools, long-term

In this category, the CEO underlined the contribution of the bank to the economy by using conservative risk management policies, strong liquidity position and robust provisioning levels. He specifies the perspectives of the bank regarding bank performance and underlines the top position of the bank.

Category 3: Positive financial results

Key words: quantitative, results, net profit increased, operated income reached, cost/income ratio improved, qualitative improvement, new core banking system, project, enabling, migration

The CEO refers to positive financial results in the financial statements of the bank and also to quality growth by highlighting the project which was run in 2012 and enabled the migration in January 2013.

Category 4: Gratitude

Key words: gratitude, all clients, shareholders, business partners, loyalty, support.

In this category, the CEO expresses the gratitude for all clients, partners and shareholders.

The Chairman and CEO statement of 2013

Category 1: Business environment

Key words: different, economic, recovery, slight growth, exports, foreign investments, stable exchange rate, low inflation rate, growth story,

In this category, the CEO highlights the growth story of the bank in accordance with a recovery of the business environment.

Category 2: Positive financial results

Key words: relevant performance, top 3 positions, disciplined growth, balance sheet growth, deposits growth, gross loans grew, capital position solid, healthy organic potential, return on shareholders' equity ratio grew.

In this category, the CEO presents the performance of the bank from the perspective of positive financial results. He presents a short history of growth since 2008 from the perspective of the shareholders equity ratio.

Category 3: Strategies and perspectives of the bank

Key words: activities, projects, value creation, priority, efficient, effective, combating weaknesses, responsibilities, team, directors, managers, staff, achievements, core-banking system, changes, interface, functionalities, organizational streamlining, new developments, the foundation of the results, SME line, Retail line, Corporate line.

In this category, the CEO presents the achievements of the bank and highlights the core of these achievements referring to the SMEs, retail and corporate services.

Category 4: Gratitude

Key words: Thank shareholders, clients, and staff.

In this category, the CEO expresses his gratitude to clients, staff and the shareholders of the bank.

In 2013 statement, the CEO feels very proud of the achievements of the bank.

RESULTS AND DISCUSSIONS

The auditors` report between 2009 and 2013 is categorized, as follows:

Category 1: Basic sections of legal responsibility needed to be completed by both parts

In this category, the auditors present the legal responsibility of the audited bank and the audit. In all of the auditors` reports during 2008-2013, the sections were divided into: Section 1: Report on the consolidated financial statements; Section 2: Management`s responsibility for the consolidated statements; Section 3: Auditor`s responsibility; Section 4: Opinion; Section 6: Other matters and Section 7: Report on conformity of the administrators` report whit the consolidated financial statements have an identical content.

Category 2: Recommendations for Banca Transilvania

In this category, the auditors` report of 2008 recommended that the bank should revise the estimated impairment loss provision for loans, the advances to customers and net lease investment based on the internal methodologies developed after the date of the approval of the consolidated financial statements. This recommendation is made based on the uncertainties on the local and international financial markets regarding assets valuation and due to inherent limitations mentioned by the bank. In the auditors` report of 2009, the recommendations were focused on the limitations related to operating environment and assets valuation in the financial statements.

Category 3: Observations that are not part of the audited financial statements

In this category, the auditors make the observation that the bank reported in lei the consolidated balance sheet and income statement but the Group presents in Euros the financial statements mentioned for the convenience of the readers.

The Chairman and CEO statement of Banca Transilvania from 2009 to 2013 are categorized, as follow:

Category 1: Business environment

This category is present in all of the analysed CEO statements, in this category the CEO presents the business environment that the bank is a part of and in every statement this environment is uncertain but the bank manages to operate in this environment.

Category 2: Positive financial result

This category is present in the CEO statement during 2010-2013 and the CEO expresses proudly the positive financial results of the bank even though the business environment is uncertain.

Category 3: Implementing the audit recommendation

This category is present in the 2009 and 2010 CEO statements. The CEO implements the auditor`s recommendation regarding the estimated impairment loss provision for loans, the advice to customer and net lease investments based on internal methodologies developed that can be revised after the date of the approval of the consolidated financial statements.

The auditors specify that the recommendation is made due to uncertainties on the local and international financial markets regarding assets valuation and due to inherent limitations mentioned by the bank.

For the net lease investment, BT has implemented a platform that provides the customers with advice and co-financing for business turnover or new investment projects.

The solutions presented under business environment category for 2010 are based on the auditors` recommendation regarding the supply of funds, cash management and advisory services. The CEO mentions the improvement of the operational program that is in the auditors` recommendations that conducted to a positive result in 2010. Therefore, the auditors' recommendations lead to a positive financial result.

Category 4: Negative financial results

This category is only present in the CEO statement of 2010. The CEO mentions the negative results in a manner that is justified by the economic environment by avoiding responsibility of the management for the negative financial results.

Category 5: Strategies and perspectives of the bank

This category does not appear only in the CEO statement of 2009 as in that statement the strategies applied by the bank were all focused on the auditors` recommendations. In this category, the CEO presents the strategy of the bank and the perspectives and presents the changes that the bank will make in the years to come.

Category 6: Personal image of the bank

In this category, the CEO has a very positive opinion about the bank and the bank's team. He considers that the bank's team active players sustain its economic well-being. The CEO has a very good personal image focusing their courage, intelligence, professionalism and responsible spirit.

Category 7: Gratitude

At the end at every statement, the CEO expresses the gratitude to the bank`s clients, partners, shareholders and the team.

CONCLUSIONS

After analysing the auditors` reports and CEO statements of Banca Transilvania, we conclude that the management of the bank takes into consideration the auditors' recommendations and implements them that answers our first question 1: Are audit recommendations considered and implemented by the bank`s management, and after implementing the recommendations of the auditors in 2009 and 2010, the CEO statements present a positive financial result of the bank. Therefore, our results confirm other studies:

- the audit has a protector and helper role (Roussy M., 2013);
- a periodic internal audit manages to streamline risk management objectives and achieve medium and long-term added value (Petrascu D., Tieanu A., 2014);
- between internal audit and company performance, there is a strong link that results in increased company value and goals (Caratas M.A., Spatariu E.C, 2014).

We found and agree with (Hooghiemstra R., 2010) that the CEO statements explain the causes of negative and positive results in every year analysed.

After analysing the independent auditors` report of Banca Transilvania, we came to an interesting conclusion that there are 6 sections in the report that are identical, only few words of some sentences are changed, but the meaning of the sentences remains the same. In independent auditors` reports in years 2010, 2011, 2012 and 2013, the only recommendation they gave is the one that "does not form a part of the audited consolidated financial statement". This makes us conclude with 3 questions: 1:Does the bank have an extremely efficient internal control and the auditors have nothing to recommend?2: Are the real recommendations not transparent for the public and are these only discussed inside the Bank? And3: Is the auditing performed for the bank at a very low level? Therefore, this study can be further analyse the auditors` reports of other banks and see if any of the tree hypothesis mentioned above could be verified.

ACKNOWLEDGEMENT

This work was supported by a grant of the Romanian National Authority for Scientific Research and Innovation, CNCS – UEFISCDI, project number PN-II-RU-TE-2014-4-0291.

References

1. Beasley S. M., Clune R., Hermanson D.R., (2006), "The Impact of Enterprise Risk Management on the Internal Audit Function", *Jurnal of North Carolina State University*,3-28.
2. Craiga R.J., B. N. (2012). An exploration of the relationship between language choice in CEO letters to shareholders and corporate reputation. *Accounting Forum*, 166-177.
3. Cao L., Li W., Zhang L.,(2015), "Audit mode change, corporate governance and audit effort", *China Jurnal of Accounting Research,* Published by Elsevier, 1-21.
4. Dăneci-Pătrău D., (2014), Susmanschi G., Ruse E., „Internal Audit and Risk Management”, *SEA-Practical Application of Science,* vol.II, issue 1(3),524-531.

5. Dima Florin C., (2013),"Risk management from the perspective of internal audit", *Management Strategies Journal*.
6. Drăgan Pop M., (2008) „Auditul intern - delimitări conceptuale şi limite", *Congresul Profesiei Contabile Din România,* Ed. CECCAR, Bucureşti,107-115.
7. Ducu C., (2013), " Importance of internal audit within an entety", M*anagement Strategies Journal.*
8. Egerdahl Ryan, Carol Fox, Hal Garyn, Paul Hinds, George Lewis, Albert G. Holzinger, (2012) , "Risk Management and Internal Audit: Forging a Collaborative Alliance", *Executive Raport RIMS,* New York, April, 1-14.
9. Haney, W., Russell, M., Gulek, C., and Fierros, E. (Jan-Feb, 1998). Drawing on education: Using student drawings to promote middle school improvement. *Schools in the Middle*, 7(3), 38- 43.
10. Hooghiemstra R. (2010). Letters to the shareholders: A content analysis comparison of letters written by CEOs in the United. *The International Journal of Accounting*, 275-300.
11. ICAEW. (2010). *AUDIT OF BANKS:LESSONS FROM THE CRISIS.* Royal Charter.
12. Jorion P., (2007), Financial Risk Manager, Ed. John Wiley & Sons, Inc., Hoboken, New Jersey.
13. Kabiru, I. D. (2013). An Assessment of the Quality of Auditors' Reports in the Nigerian Banking Industry. *Journal of Finance and Investment Analysis*, 63-75.
14. Knight F. H., (1964), Risk, Uncertainty, and Profit, Ed.nAugustus M. Kelley, Bookseller New York, 51-52.
15. Millichamp, A. (1996). *Advanced Auditing.* London: Oxford University Press,.
16. Petrașcu D., Tamaș A., (2013), "Internal Audit versus Internal Control and Coaching", P*rocedia Economics and Finance*, Published by Elsevier, vol. 6, 694-702.
17. Petrașcu D., Tieanu A., (2014), "The role of Internal Audit in Fraud Prevention and Detection", *Procedia Economics and Finance*, Published by Elsevier, vol. 16, 487-497.
18. Rohana O., I. ,. (2014). Influence of audit committee characteristics on voluntary ethics. *Procedia - Social and Behavioral Sciences*, 330-342.
19. Roussy M. (2013). Internal auditors' roles: From watchdogs to helpers and. *Critical Perspectives on Accounting*, 550-571.
20. Schneider A., (2008). The effect of auditors' internal control opinions on loan decisions. *Journal of Accounting and Public Policy*, 1-18.
21. Stemler S. (2001). An Overview of Content Analysis. *Practical Assessment, Research & Evaluation*.
22. Zona, F. (2013). Board leadership structure and diversity over CEO time in office: A test. *European Management Journal*, 672-681. 16.
23. Walker L.Paul, Barton L. Tomas, Shenkir G. William,(2002) Making Enterprise Risk Management Pay Off, Ed. FEI – Financial Times/Prentince Hall PTR, America.

ORGANISATIONS OVERSEEING THROUGH THE AUDIT COMMITTEE

Emilia VASILE
„Athenaeum" University of Bucharest
Bucharest, Romania
rector@univath.ro

Marcel GHIȚĂ
marcel.ghită@gmail.ro

Abstract: *Financial oversight of the financial reporting process is one of the major responsibilities of audit committee members. Besides the concerns of knowledge and understanding of financial reporting in accordance with national regulations, the audit committee must ensure a high quality and the availability of financial reporting, transparency embodied in financial statements, consistent and comparable from one period to another, but also amongst organizations. In these circumstances, the audit report for the financial reporting process oversight of the Board of the organizations must have a certain structure, as shown in Appendix - Audit Committee Report. Another important responsibility of the audit committee is the audit oversight function within the organization, which includes internal audit activity and external audit of the organization. In this regard, the audit committee assesses the internal audit function on the following elements: independence, objectivity, compliance audit methodology, findings and quality and the implementation of audit recommendations. The audit committee pays a particular attention to assessing the experience of auditors, required resources and relationship with the management of the organization. Regarding external audit, the audit committee assess the selection of financial audits, the level and quality of services provided and their reporting system. Also, the audit committee evaluates the relationship between the external audit and the internal audit within the organization and its relationship with the board, based on the analysis of the latest external audit report received by the organization. The article deals with the position of the Audit Committee, which is in a unique situation of assessing the audit function with the financial reporting system of general management of the organization, and analysis of any non-audit services required by the organization.*
Keywords: *management, organization, fraud, internal auditors, internal control, external auditors, audit committee*

1. THE SUPERVISION OF THE FINANCIAL REPORTING PROCESS

The supervision activity of the financial reporting process is one of the most important - and difficult - responsibilities of the audit committee members.

In this sense, the members of the audit committee must gain an understanding of issues regarding the financial reportings affecting the company and the audit committee must ensure that there is a process of financial reporting of high quality and that financial statements are transparent, consistent and comparable .

The management board, the auditors and the audit committees should have distinct roles and responsibilities in the financial reporting process. However, they share a common goal, namely ensuring financial reporting of the highest quality.

Regarding this, the audit committee should be informed by the management on the significant problems of the financial reporting, to check the company's financial statements and, together with management, to discuss these matters with the internal and external auditors.

The solid business and risks knowledge the company may face, allows the members of the audit committee to ask correct and concrete questions on financial statements and other supplementary declaration.

Therefore, *the audit committee must acquire an understanding of the significant financial reporting issues that concern:*

• the financial results compared to the established results;

• the consistency of the facts presented in the financial statements by comparison with the non-financial statements;

• the major changes in the company's balance sheet or changes in trends or in the financial reporting;

• the accounting principles, including the changes taking place, and the rules and practices in the field in which the company operates;

• the significant matters that may reflect the credibility of the intermediate accounting and of the reporting practices;

• the significant transactions with third parties;

• significant topics in accounting or audit area that may affect the company or influence the quality of earnings on the overall quality of financial reporting, such as:

- declaring overstated restructuring tasks that have periodic results in the company's revenue;

- excessive burdens in research and development areas, as well as recognition of the liabilities for future operating costs in combination of acquisitions;

- the use of unrealistic assumptions in estimating debts in order to increase revenues, for example, sales ratability, loan losses or on guarantees costs);

- using intended practices to incorrect records or uncorrected errors;

- Incorrect recognition of the revenue, before completing the sale, the products delivery to customers, before completing the transactions.

For these reasons, the audit committee, regarding the evaluation of the quality of income, should consider any warning - "red flag" - that could indicate poor management. In practice the Committee should pay particular attention to the issues of the revenue recognition, the complexity of the arrangements with customers, the acquisition of intangible assets, the restructuring tasks of the company or the reduction of the burdens etc.

With the occasion of the management financial statements verification, the audit committee can ask managers or auditors questions, like the ones from the Ernst & Young list and from the Audit Committee Mechanism document, structured on fields, which contains questions like:

• *Financial instruments*
- does the company want to invest in some unusual types of financial instruments?
- what is the nature and extent of their use?

• *Customer accounts / loans*
- was the budget for doubtful customer rated?
- are there reserves for loans that cannot be reimbursed?
- is there a higher concentration of risk on loans in certain areas?

• *Inventory*
- What procedures were taken to ensure that the inventory does not contain obsolete or excess inventories and its decrease was appropriate?
- was there any undertaken evaluation to determine if the inventory is properly registered at the lowest market price?

• *Investments in affiliates*
- How the company does takes into account investments in partnerships, collaborations or other affiliates?

• *Long-term liabilities*
- are there unforeseen commitments or liabilities that were not included in the financial statements?
- does the company complies with its commitments on loans and repayment of debt?

• *Income and expenses*
- How the company policy to generate income compares with the other companies in the same field?
- Are there included in the financial statement unusual or extraordinary income or expense items?
- what did the management and auditors do to consider the existence of some problems regarding revenue recognition and how should they be considered?

• *Third Parties*
- are there any recordings of unusual transactions with third parties?
- What was done to ensure that they are properly recorded and disclosed, accordingly, the financial statements?

• *Special Transactions*
- Which is the purpose of the special transactions?
- These special transactions are understood and explained by management?
- The special recording transactions include critical information on investor understanding of the business purpose and economic nature of the transaction?

The Audit Committee, as a result of the financial reporting process supervision, on behalf of the Board, writes a report, as shown in the example found in the Annex. 1 - The report of the audit committee.

2. SUPERVISING THE AUDIT FUNCTION

Another major responsibility of the audit committee is the proper understanding of the audit function, which includes both internal and external audit function.
The Audit Committee verifies internal auditing procedures and recommendations provided by the management and also examine the planned activities, the resources requirements and the costs for assessing the external auditor's independence.

The members of the audit committee should have an understanding of the planning and conducting the audit work. The internal and external auditors should meet with the audit committee to provide information on the processes of audit. Periodically, the new members of the committee should be informed of the developments in the organization's auditing processes.

The audit committee should evaluate both the quality and experience of internal auditors and the objectives which they proposed, and also the corresponding amount of resources that should be used for the internal audit function. In this regard, the audit committee may encourage the management to increase the resources available for the internal audit function, if such a step is necessary.

Also, the audit committee takes into consideration the adequacy and rewarding of its staff, while maintaining the quality of work and ensuring staff continuity. *Periodically, the audit committee examines the effect of outsourcing the internal audit function.* Similarly, the audit committee verifies annually the external audit team members' qualifications and performances, including the external auditor answer to the expectations of the audit committee.

The audit committee must be directly involved in the appointment, replacement, dismissal and reappointment of the director of internal audit and, similarly, the audit committee must be responsible for recommending to the board of directors external auditors selected by the company and eventually for determining the correctness for giving up their services.

Considering that the management is working directly with the external auditors, it is always in a better position than the Board of Directors regarding the assessment of the level and quality of services provided by the external auditors. In these circumstances, the management usually makes proposal for the appointment of external auditors to the audit committee. The Audit Committee shall examine the proposal and recommends the selected audit firm to the board of directors that appoints external auditors with the approval of the Board.

After the selection of the external auditors, the board of directors defines their responsibilities in a letter that represents a commitment on the types of services that will offer the company and the expenditure estimates.

The audit committee should analyze the results of the latest audit provided by the external auditor, as well as any complaints or disciplinary action related to them, if there were any, applied by the professional bodies in the field. Meanwhile, if the internal audit function is assessed periodically, the audit committee may also investigate the results of the function assessment.

The members of the Audit Committee should focus on systematically orient the management and the work of the internal auditors and examine the performance of the internal audit activity. To achieve these objectives internal audit committee members must be concerned with the following aspects:

a) the head of the internal audit compartment skills and to whom he reports to;
b) the reporting manner of the internal audit department head;
c) when was last revised the Internal Audit Charter?
d) the development of the internal audit plan;
e) how efficient does the management team implements actions over which they agreed during the audit activity?
f) is the internal audit activity carried out in accordance with IIA Standards and with the Code of Ethics?
g) is the position of internal auditing in the entity at a sufficiently high level and detached from functional areas to ensure independence?
h)does the internal auditors manage to avoid activities that would undermine their objectivity?
i) the fulfillment of the internal audit plan;
j) does the internal audit have a quality assurance and improvement program?
k) does the program contain an external quality assessment every five years as required in standards?
l) does the internal audit has sufficient resources to provide an objective assurance about risks and controls?
m) how does the chief of the audit compartment respond to the examination made by the Audit Committee?

The external auditor's / audit firm assessment for its selection made by the audit committee can be done using a questionnaire containing the following questions:

NC	QUESTIONS	YES	NO	Comment
1.	Which are the audit processes and on what areas will they focus on?			
2.	Is the company independent in relation to the audited company?			
3.	What is the control policies quality of the company?			
4.	What is the company's expertise in auditing?			
5.	Which is the international extensions o the company?			
6.	Which will be the team of internal auditors appointed to audit the company?			
7.	What is the expertise and qualifications of the designated audit team members?			
8.	To what extent and how will the partner participate in the work of external audit?			
9.	Does the responsible partner for this commitment has leadership skills and experience to bring all the necessary resources to the company?			

10.	Does the responsible executive director for this engagement demonstrates a high degree of integrity in matters concerning the audit committee?			
11.	What other professional services will be provided by the audit firm or by another firm?			
12.	What are the estimated fees, which is the basis for determining them and how their differences will be arranged between the estimates and the actual charges?			
13.	How will it be communicated the significant deficiencies or other comments regarding the internal control?			
14.	As does he shares his knowledge and expertise within?			
15.	How will the company use the IT technology during the auditing mission?			
16.	Must the audit committees be capable of assessing the performance of the external auditors and make them accountable in case of failure in their professional duties?			

The audit committee must verify the objectives the internal and external auditors planned, their work, any changes in the planning activity, assessing the functionality and performance of the internal control and also the degree of coordination and correspondence of their activities.

In overseeing the internal audit function, the audit committee is responsible for the coverage provided both by internal and external auditors.

Since the audit committee assists in providing direction and the aim of the internal audit function, it is in a unique position to question the degree of coordination between internal and external audit.

The audit committee has also the responsibility to verify the information related to the external auditors' fees and the total cost of an audit (internal audit and independent audit). In this regard, the audit committee must ensure that the management has not restricted, inadvertently, the audit purposes in order to reduce costs.

The responsibility of negotiating the fees with the external auditors remains the responsibility of the management, but the audit committee approves the fees for the external audit and examine whether the degree of reward for external auditors is appropriate in order to ensure a well-trained staff, able to undertake the necessary procedures for a high quality audit.

The organization may require external audit some non-audit services or services unrelated to the audit, such as taxes, IT consulting and other services. *The PANEL report* included a recommendation - the approval by the audit committee of the non-audit services that did not passed a certain level of cost. However, the report stated that this level should not be so low that the audit committee would assume a management function.

In the USA, the Commission of Financial Instruments and Transferable Securities (SEC) determined the banning of certain non-audit services, clearly established that those services were and issued rules in this regard. Initially SEC banned advisory IT services, a position supported in that time, by Ernst & Young and another firm from the five largest audit firms and consultants, but subsequently did not issue rules in this regard. Meanwhile, the SEC considered necessary to prohibit the outsourcing of the internal audit regarding the financial problems, but finally allowed the auditors to provide up to 40% of the services regarding clients' financial problems.

In 2000, the SEC indicated a range of permitted non-audit services that will not damage the independence of the auditor:

• audit-related services;
• taxes related services ;
• the assessment, design and implementation of the internal accounting and risk management controls, for example checking the information from the control systems;
• the insurance evaluation for other post-employment benefits, pension or similar obligations;
• tasks related to advising on insurance for companies and other customers;
• assessments for business tax and intangible issues;
• advisory services on investments;
• corporate finance services.

Despite the SEC submission of a range of non-audit services that auditors were allowed to take for their clients, there were still expected imposed restrictions on the IT consulting and on the internal audit outsourcing.

In the auditors practice, the regulations on the prohibition of other non-audit services, was not supported because there are many so-called non-audit services that were performed traditionally by auditors, including a wide range of services relating to taxes that can only be undertaken by auditors. In addition, the accounting firms provided a range of advisory services that assist clients in managing risks more effectively and in an effective implementation of the control activities.

There should not be any concerns about the possible effect on affecting the objectivity of auditors in the audit process, when there are fees for non-audit services, because by their nature these services do not generate conflict with the audit process.

The standards, codes of ethics and professional regulations for auditors, together with the consequences of violating them, ensure an effective protection in order to maintain objectivity.

In this sense, Ernst & Young has set understandable measures to protect the quality control that is applicable to each audit. In addition, the audit committees are able to assess the nature of the services provided by the non-audit fees charged and determine the objectivity and professionalism of the audit firm. At the same time, we must bear in mind that due to their professionalism, auditors are dedicated to initiating sincere dialogues with the audit committees in the case of occurrence of such circumstances.

References

1. Marcel, Ghita (2008) - *Corporate Governance*, Bucharest, Economic Publishing House
2. * bill amending and supplementing Law no. 672/2002 on public internal audit

Annex

The audit committee report

The Audit Committee oversees the financial reporting process on behalf of the Company's board of directors. The management has a great responsibility for the financial statements and the reporting process, including the internal control system. While fulfilling the surveillance responsibilities, the Committee examined the annual financial statements together with the management, including a discussion on quality, not just the acceptability of the accounting principles; the reasonableness of significant judgments; and the clarity of the information in the financial statements.

The Audit Committee has checked together with the independent auditors who are responsible for expressing opinions on the compliance of the audited financial statements with the generally accepted accounting principles, their judgment on the quality, not just the acceptability of the accounting principles of the company and also other topics to be discussed under the generally accepted auditing standards.

In addition, the committee discussed with the auditors the issue of their independence from the management and the company, including matters required to be discussed by the Auditing Standards Board on independence and consider the compatibility of the non-audit services with the auditor independence.

The Audit Committee has discussed with the company's internal and external auditors on the main goal and on the plans for such audits activities. In this regard, the Audit Committee meets with the internal and external auditors, with or without the presence of the management, to discuss the results of the examinations, their evaluation on the internal control of the company and the quality of the financial reporting, that the committee has had four meetings during the fiscal year audited.

Based on the verifications and discussions mentioned above, the committee recommended the board of directors who approved the audited financial statements to be included in the Annual Report and in the 10-K Form for the year ended at 31st of December of the audited year in order to respect the SEC provisions. The committee and the board of directors recommended also, after it will be the subject to shareholder approval, the selection of independent auditors of the company.

1st of March , 20XX

Chairman of the audit committee,
Member of the audit committee,
Member of the audit committee,

LAW

CONSIDERATIONS ON INSUFFICIENT LEGAL REGULATION OF SPECIAL ALLOCATIONS MADE BY THE CENTRAL EXECUTIVE AUTHORITY

Ionel BOSTAN
Doctoral School of Economics, Stefan cel Mare University, Suceava, Romania;
ionel_bostan@yahoo.com

Abstract*: Our approach aims to reveal critically aspects derived from the regulation method of distribution of Budgetary reserve fund and emergency fund - both of the government - seen by us as special allocations made by the central executive authorities, which require extra regulation because they aim at funding emergency or unforeseen expenses and urgent actions to eliminate the effects of natural disasters occurring during the budget year. Lately, these expenses having high share in the state budget, review of legislative provisions on the matter is imposed. Incidentally, in this respect there are presented conclusions by various experts/ institutions, found in some papers / reports we have consulted, together with specific legislation and literature to develop this paper.*
Keywords*: budget reserve fund, intervention fund, Government, officers of budgetary expenses, unforeseen or emergency expenses, the Court of Accounts, Tax Council*

1. SOME CONSIDERATIONS OF ECONOMIC AND LEGAL PERSPECTIVE ON GOVERNMENT ALLOCATIONS OF SPECIAL TYPE

The issue of public financial resources in terms of training and allocation / use in general, is one that deserves full attention, being treated as such by researchers in the field of budgetary law (Aniței, 2011; Drosu-Şaguna & Tofan, 2010; Bostan, 2007, 2008). The situation is all the more topical, since economies have not fully rebounded after the last global financial crisis (Oprea & Petrișor, 2011; Stoica *et al*., 2012; Maha & Mariciuc, 2009).

Referring to our theme, we show that in Romania, there was established a mechanism to use public funds designed to cover expenditure for emergency/ contingency of the principal officers of the central/ local budget, occurred during the fiscal year, us, addressing things here as being located in an area of allocations of special type of reasons that will be revealed in this paper.

Obviously, in this respect there is a certain legal framework, given by the Public Finance Act (Law no. 500, 2002), which refers to the creation, allocation and use of funds available to the Government - the reserve and the intervention fund.

The first fund (the reserve) increases/ supplies during a budgetary year (*cf*. art. 54 of the Public Finance Act) with the budgetary credits canceled at the request of the main officers, following the postponement/ abolition of the budgeted tasks by the annual law of state budget and corrections along the way. It is meant to represent a real backup, used only in case of the major difficulties and only as a last resort, after having exhausted other avenues of financing of an object or an action; "the characteristic of urgency accompanies allocating these amounts from the moment of discovering the necessity state regarding expenses incurred during the budgetary exercise until the payment for which they were requested" (CCR/ Decision no. 558, 2012). The amounts granted from funds mentioned above have a free and general character. They are granted without implying an obligation to be reimbursed, with no control on the final objective allocation provided in the law, not being stipulated a targeted, specific, destination, but only the phrase "current and capital expenditure". Therefore, funds being depersonalized often appear imperfections/ interpretation and bias in their allocation. An evolution of the number of Government decisions on allocations from the reserve fund, in 2007-2013, is shown using a chart below (Fig. 1).

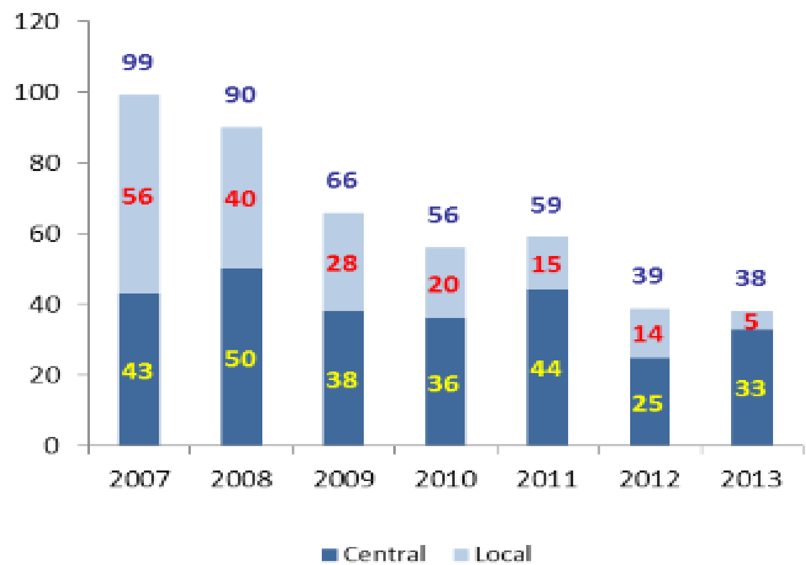


Fig. 1. Number of government decisions on allocations from the reserve fund
Source: Fiscal Council Report on 2013

Regarding Fund intervention, we show that it can be increased by the Government during the year with amounts from the budget reserve fund, depending on the needs regarding ensuring the necessities of annihilation of effects of natural disasters. What can be seen from the study of the regulatory framework is that the Law does not specify explicitly categories of expenditure that may be incurred in the reserve fund and there are no limitations on the amount of aid, which provides space for discretionary and non-transparent allocations.

In addition, repeatedly, the government has resorted to derogations from the Public Finance Law through which is determined the use of the reserve fund which does not manifest the character of emergency/ contingency expenditure (CF/ Fiscal Council, 2013), because, for example although reducing the stock of arrears or payment writs of execution represent valid targets, they should be included in the draft budget, possibly in rectification, to corresponding items of expenditure, not affecting the reserve fund.

All this made in time to be expressed some critical views (SAR/ Academic Society of Romania, 2013) related to transparency, fairness, efficiency etc.

2. THE LEVEL OF GOVERNMENT ALLOCATIONS OF SPECIAL TYPE

In international practice (Lienert, 2010; CF/ Fiscal Council, 2013), state budgets include a reserve fund typically limited to 1-3% of total public expenditure, its level being established by Parliament, to which there are regularly transmitted reports on use of the Fund, size and destination of the expenditure incurred.

In Romania, in 2013, there were allocated from the budget reserve fund approx. 950 mil. Lei (0.4% of the total expenses) as follows: approximately 800 mil. Lei to central administration and 150 mil. Lei to the local administration (Fig. 2).

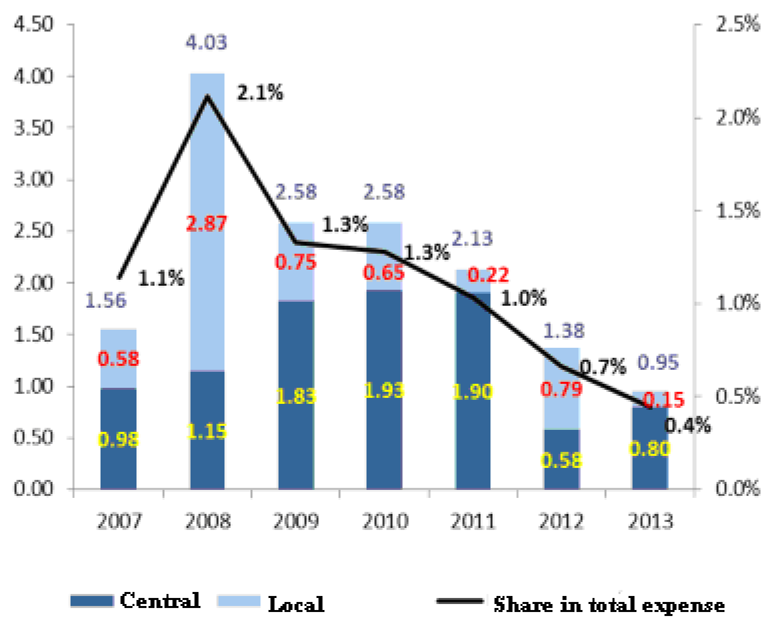


Fig. 2. Total allocation from the reserve fund available to the Government (bn. Lei)
Source: Fiscal Council calculations based on data from Government Decisions on allocation of funds from the reserve fund (2014)

Regarding the utilization of the intervention fund, referring only to the level of 2013, amounted to 32.7 mil. Lei.

Compared to 2012, allocations from the Reserve Fund decreased by approx. 425 mil. Lei (30.95%) in the context of reduction in transfers to local authorities with 645 mil. Lei and to increase by 219 million. Lei of amounts diverted to the central government.

3. THE CRITICISMS AND RECOMMENDATIONS OF PROFESSIONAL BODIES IN RELATION TO THE ESTABLISHMENT, ALLOCATION AND USE OF FUNDS AVAILABLE TO THE GOVERNMENT

3.1. Results of audits by the Court of Accounts of Romania

In the literature notions of urgent or unforeseen expenditures are defined as follows: the urgent are those costs that require a solution for which is not permitted deferral; unexpected are those expenses whose appearance cannot be estimated.

Following special checks carried out by the Court of Accounts of Romania (RCC/ Court of Accounts Romania, 2009) came off the idea that these concepts are too vaguely defined in the current legislation. On the other hand, there is no clear definition of the "administrator" of these funds.

But none of these could prevent the Ministry of Finance to develop a set of criteria for defining the urgency or unforeseen character of expenditure to be financed from these funds, with opinion to draft decisions by the Government including in terms of need and opportunity of allocation of amounts in this regard.

In the document above mentioned, the Court of Accounts held that at the Executive level there is not done any analysis on the need/ opportunity of allocating funds from budget shown, although they are distributed by the will of the government and at its level should be clear records regarding the amounts distributed and all beneficiaries of amounts.

Then the Ministry carrying large sums to this chapter (Ministry of Development), there were no clear and formalized criteria of classification of expenditure to be financed, in terms of cataloging them as urgent/ unforeseen expenses, resulting in an arbitrary distribution/ use. In fact, only the initiators of draft decisions of government employment is concerned that expenditure to be funded, which we consider abnormal situation in the current context.

It was noted the lack of a guide of the principles and procedures to be followed in the allocation of sums mentioned nature, making it difficult to ensure accuracy and consistency of information provided by the ministry.

Nor was created a computerized database containing information on those amounts in real time and it has not been realized the monitoring of these amounts, and there are no reports on the matter and no other statements made to the MFP.

In a more recent report (RCC/ Court of Accounts Romania, 2014), the same institution indicated above shows that by Law no. 5/2013 for the budget reserve fund to the Government, there were approved 200 mil. Lei to finance urgent/ unforeseen expenses. But these have increased more than fivefold stripping being canceled some proposed budgetary credits by officers. The amounts in this fund have been used to increase the budgets of certain principal central/ local officers, based on 38 government decisions, having held similar practices to the preceding period.

Among these, the distribution of funds to officers that canceled them for actions that were not in fact urgent/ unforeseen corrections of errors made by officers in budgetary planning, financing for religious field, works of investment in objectives in conditions of failure to state reason for priority related to such other objectives.

Thus, the reserve fund has not actually been used for the purpose for which it was created, allocations being made without transparent criteria, the fund accounting actually a way to supplement budgets of officers without legislative approval, functioning almost as a parallel budget and without parliamentarian control.

Instead, it was found that the emergency fund available to the Government included in the state budget for 2013 has been formed and used according to the legislation of public funds specific to this fund.

3.2. Recommendations found in the reports of the Fiscal Council

Taking into account best practices internationally in the field, the Fiscal Council recommends the explicit identification of expenses that may be incurred in the reserve fund and more transparency, including through regular reporting to Parliament of complete data about this fund.

Thus, it requires detailing allocations stating the conditions/ criteria for allocation and breakdown per loan. Also it is recommended capping the amounts that can be distributed and used from the reserve fund as a percentage of total expenditure (CF recommends a level of approx. 1%).

Noteworthy is that with regard to the Government's intervention fund, the procedures are appropriately reflected in the text of the law, the Fiscal Council not seeing deviations from established principles and rules in the area analyzed.

4. CONCLUSIONS

Given that last period was not very favorable in terms of economy, budgetary funds, including those to which we refer in this paper, should be managed/ administered with far more concern/ responsibility.

The conclusion from the above is that in recent years, so even after the global financial crisis, in Romania there was a low degree of transparency in the management and administration of public funds from the budget reserve fund and emergency fund.

Therefore, experts (economists/ lawyers) involved in the machine of Executive, have the task of sound analyzing the need and opportunity of allocations with the title mention, and the achieving/ initiation of draft rules to improve future matters described, avoiding the limit to only providing data regarding the availability of these funds at a time.

Acknowledgments. We express our appreciation to the late Prof. PhD Joan Szabo - Romanian Court of Accounts, whose contribution to this work was of great significance. We gratefully acknowledge the contribution of the late Prof. PhD Ion Macovei - Al. I. University of Iasi/ Faculty of Law (Doctoral Leader) - to this paper.

References

[1]. Aniței, Nadia-Cerasela (2011). Drept financiar, Editura Universul Juridic, București.
[2]. Bostan, I. (2008), Drept financiar, Editura Tehnopress, Iași.
[3]. Bostan, I. (2007), Drept financiar comunitar, Editura Tipo Moldova, Iași.
[4]. CF/Consiliul fiscal (2014), Raportul anual pe anul 2013 al Consiliului fiscal, București.

[5]. CCR/Curtea Constituțională a României, Decizia no. 558 (2012) referitoare la excepţia de neconstituţionalitate a dispoziţiilor art.V, alin. (1) teza I din Ordonanţa de urgenţă a Guvernului no.15/2012 privind stabilirea unor măsuri financiare în domeniul asigurărilor sociale de sănătate şi al finanţelor publice, Publicată în Monitorul Oficial no.382 din 07.06.2012.
[6]. Drosu-Şaguna, D.; Tofan, Mihaela (2010), Drept financiar şi fiscal european, Editura C.H. Beck, Bucureşti.
[7]. Legea 500 a finanțelor publice (2002), On line:
http://www.dreptonline.ro/legislatie/legea_finantelor_publice.php
[8]. Lienert, Ian (2010), Role of the Legislature in Budget Processes, Fiscal Affairs Department, International Monetary Fund.
[9]. Maha, L.G., Mariciuc, D.F. (2009), Characteristics of the financial crisis in 2008 and its implications on Romanian economy, Paper no. 27180, *MPRA/ Munich Personal RePEc Archive*.
[10]. Oprea, F.; Petrişor, M.B. (2011). Public Expenditure Policy In The Context Of Economic Crisis - Challenges And Implications, *European Integration – New challenges*, Pages 986.
[11]. RCC/Curtea de Conturi a României (2009), Raport privind Auditul performanţei modului de constituire, alocare şi utilizare a fondurilor la dispoziţia Guvernului, Bucureşti.
[12]. RCC/Curtea de Conturi a României (2014), Sinteza raportului public pe anul 2013, On line:
http://www.curteadeconturi.ro/Publicatii/Sinteza%20RP%202013.pdf
[13]. SAR/Societatea Academică din România (2013), Policy Brief no. 65, București, On line:
www.sar.org.ro
[14]. Stoica, O.; Capraru, B. (2012), The Current International Financial Crisis And The Financial Supervision Institutional Arrangements Effectiveness In The European Union Countries, *Revista Economica, Lucian Blaga University of Sibiu*, no. 4: 590-597.

IN BRIEF: PROS AND CONS OF CORPORATE CODES OF CONDUCT

Ada-Iuliana POPESCU
Alexandru Ioan Cuza University of Iasi, Romania, Faculty of Economics and Business Administration
Iasi, Romania
ada.popescu@uaic.ro

Abstract: *During the last decade the fight against private sector corruption has intensified. Governments, international organizations, NGOs have prioritise it due to the devastating effects that corruption has on economy, governance and society in general. Private sector corruption has proved as virulent and dangerous as public sector corruption. As a result of government and civil society pressure, corporations have instated new codes of ethics or updated their already existing ones to meet the anti-corruption demands. However, their efficiency has proven weak. Scholars and practitioners have been engaging in different debates focused on the pros and cons of corporate codes of conduct. The present article summarises the results of these debates, underlining the features of an efficient code of conduct.*
Keywords: *codes of ethics, codes of conduct, business codes, corporate codes.*

5. INTRODUCTION

Having control over business activities, employees, money and public image is essential in managing a company. However, companies are under a lot of pressure to achieve growth in spite of the economic, political and social turmoil our world is facing today. Unethical behaviour seems to be sometimes the easy way to achieve financial gains. Thus, the risk of corruption in the private sector remains strong.

One of the management tools used to maintain control over a business is the code of conduct. Various international organizations such as United Nations Office on Drugs and Crime (UNODC), World Bank, Organization for Economic Co-operation and Development (OECD) and Transparency International have issued guidelines and given recommendations on developing corporate codes of conduct. However, these guidelines are more focused on adopting codes of conduct that will generate economic benefits, rather than focusing solely on fighting corrupt practices for ethical reasons.

Since the ‘90s companies have adopted codes of conduct or have upgraded their old ones in order to adjust corporate behaviour to economic, social and legal requirements. Thus, an impressive number of companies around the world have followed this trend. Different studies around the world prove it. A study done in 2004 revealed that 69% of the largest 25 companies in the United States (US), United Kingdom, and Sweden had a code of conduct published on the Internet. It seems that codes of conduct were most common among United States companies (88%), followed by European companies in general (64%), and Swedish companies in particular (56%) (Ljungdahl, 2004). Also, multinational corporations operating in emerging economies such as BRICs’ countries have been adopted codes of ethics. For example, 189 companies out of 500 companies operating in Brazil have adopted codes of conduct (Ardichvili, 2013).

Codes of conduct are relatively new. Their history can be traced back to the United States in the 1950s and then in the 1970s, when American parent companies have developed such codes for their subsidiaries operating in Europe.

However, the name and content of codes of conduct varies from company to company, according to their size, organisational culture, operating business environment, their specific business activity and their commitment to follow business ethics. A code of conduct has been described as “a written, formal document consisting of moral standards and guidelines intended to help guide employee or corporate behavior” (Giorgini, p.1, 2015; Schwartz, 2002). Different synonyms such as code of ethics, business code, code of practices, business principles, code of business conduct etc. are used to describe the set of conduct rules that companies operate under. However, their different names have sometimes produced confusion in the literature.

The concept of corporate code of conduct has suffered an evolution triggered by changing social and economic needs. Thus, in the 1950s codes of conduct were merely describing the company mission, values and goals, giving directions to employees in order to serve the company interest and increase its profits. Today, corporate rules of conduct are also oriented towards the public needs, emphasizing corporate responsibility when it comes to serve public economic and social goals.

However, the content and the focus of codes vary greatly around the world, influenced by the continental business culture that companies have been created and/or operate in. For example, United States companies are favoring codes of conduct while European companies do not. This is due to United States long tradition of corporate codes of ethics. Also, US codes are focused more on rules regarding employees’ behavior that ensure fairness and equity, while the European codes are emphasizing the general business principles and the relationship the company develops with the stakeholders (Kaptein, 2004). Also, at the European level, codes of conduct rules vary. For instance, French companies’ codes are enforcing rules that concentrate more on customer relations and just as British companies’ codes do, they are emphasizing the idea of common responsibility of all employees in spite of their position in the company. German companies’ codes are focused on the idea of shared responsibility between management and the rest of the employees (Langlois and Schlegelmilch, 1990). In comparison, US corporate codes of conduct seem better harmonised than the European ones.

It is obvious that companies are developing codes of conduct for different reasons and under different circumstances, making their assessment difficult. Thus, the necessity and efficiency of such codes might not be always clear, generating debates and controversies.

6. THE PROS OF CODES OF CONDUCT

During the last decade, codes of conduct have been mostly voluntarily adopted by companies that are trying to protect their interests and, also, in some cases, the public interest. Thus, having a code of ethics has become the rule in corporate culture. However, how well these codes serve companies goals and public interest alike needs to be seen. Pros and cons have been outlined by business community, civil society, academia representatives and different NGOs representatives.

The reasons companies develop codes of conduct are many and different, illustrating their business conduct policy: to respond to consumer pressure and social concerns, to avoid negative media, to improve and protect corporate reputation by emphasizing corporate social responsibility and community involvement, to limit negative externalities, and to actually provide for the public good. At the same time, codes of conduct can be an effective tool against corporate corruption by keeping under control employees' behaviour in order to prevent wrongdoing that could have social and economic adverse effects.

Thus, codes of conduct can be useful for the corporation, its stakeholders, and the community that bears the effects of corporation activity.

Empirical studies show that codes of conduct will help cement a corporation's good reputation, improve the working climate inside a corporation and its business performance (Kaptein & Schwartz, 2008). At the same time, the rules of conduct will prevent unethical and illegal wrongdoing, making employees' behaviour more predictable.

As studies show, the main reason companies develop codes of conduct is to self-protect themselves, usually preventing conflict of interests at company level (Stevens, 1994). Also, a code of conduct may be used as evidence in a criminal case to show that an employee had knowledge of a prohibited activity or action and the company was pro-active in preventing it. Main sanctions for the employees that are breaking conduct rules are: termination, suspension, demotion, probation, appraisal comments, and other penalties.

In recent years, codes of conduct have become part of governmental compliance programmes that target illegal behaviour and aim to ensure fair market competition. For example, companies have voluntarily adopted such codes as a result of strong governmental legal actions aimed at curbing private sector corruption. Usually, companies prefer self-enforcement rather than governmental one, the last being disruptive to business. United States Foreign Corrupt Practices Act (FCPA) stronger enforcement had such an effect on US companies.

Another advantage of codes of conduct is the fact that these tools can be adjusted to a company's needs. Companies can enforce rules meant to prevent and sanction first hand illegal and/or immoral employees' behaviour that is sometimes hard to detect, such as corruption.

At the same time, codes of conduct can increase profitability and generate higher financial gains for the company and its employees. Codes could sustain the success of a company and also of the local economy, in general. This is a natural effect that ethics have, since people do business with other people they trust. A recent survey on corporate corruption in Europe, the Middle East, and Africa shows that growth and ethics is a match, since respondents who reported revenue growth in their business were having a code of conduct in place that reflected ethic policy, state penalties for wrongdoing and deliver training and support for whistleblowers that report corruption and fraud (Ernest &

Young, 2015). Also, indirectly, the positive effect of codes of conduct on the success of a business reflects as well on people willingness to work for such a corporation and also on investor's loyalty and on customer satisfaction.

Companies that follow business ethics are helping their employees work better. The ethical environment makes employees feel appreciated and secure, knowing that honest and ethical conduct is the norm and any violation can be promptly reported to the appropriated person indicated by the code.

In some cases, codes of conduct generate a "clean" marketing image for a company. Investors could be attracted not only by financial growth but also, by the moral, ethical driven business activity that a company performs. Also, customers prefer sometimes to buy certain products not only for their quality or their good price, but also knowing that these come from a company that conducts an ethical business activity.

Overall, there is no doubt that codes of conduct could serve both the private and public interest. However, not always their efficiency prevails.

7. THE CONS OF CODES OF CONDUCT

The existence and the use of corporate codes of conduct have been under scrutiny and critiques have been raised due to the corporate scandals that in recent years have augmented. These companies had codes of ethics but they have chosen to ignore them.

Arguments against codes of conduct come both from the public but also from the business representatives as well.

Codes of conduct proved inefficient since massive scandals such as Enron accounting scandal or Volkswagen emission scandals occurred.

It seems that codes have been developed as a mere response to public and governmental pressure on corporate social responsibility, generating a trend. In reality, the public believes that ethics are just ignored by corporations and codes are often used as a marketing tool, attracting customers' and investors' sympathy and thus, promoting the business on ethical grounds.

Codes of conduct are not binding by nature; they are just stating internal rules that have to be followed by employees. How well these rules are obeyed remains a matter of internal control and sanctioning since there is no "ethics police", external to the company. Thus, if the company does not encourage its employees to respect rules of conduct and efficiently monitor it, then they remain futile (Baker, 2007).

Other criticism focuses on the broad, vague language of the codes, especially when it comes to stating the rights of the employees and explaining the mechanism used by the company for self-evaluation. As a result, codes are not specific enough in order to shape moral behaviour and to sanction misconduct. At the same time, codes could be used against employees, containing provisions that limit their freedom to speak out and unveil unethical behaviour for fear of retaliation. In short, the content of codes varies greatly since corporations usually ignore international standards when they draft their rules of conduct. This makes their worldwide enforcement difficult, if not impossible.

Codes of conduct should address all employees, not only top management, since ethics concerns the company as a whole. Also, the codes that use a top-down approach proved to fail for a number of reasons. For instance, moral principles and rules are ignored by management at investors' pressure. It is the case of Enron management that choose to ignore the code, serving its interest. Thus, unless there is commitment from all employees, no matter their rank, to implement and respect rules of conduct, codes remain useless.

From a corporate perspective, codes of conduct could also present some disadvantages. Drafting and implementing rules of conduct is usually seen as expensive and time consuming on a short-term. These add to "dangerous", since companies expose themselves to litigations if they fail to follow their own written rules of conduct. Codes of conduct could reveal corruption problems that companies want to hide. Making them public will generate bad publicity and the loss of financial profits obtained by engaging in corruption activities.

Also, corporations operating worldwide could be exposed to different conflicts of interest due to incongruence between their codes of conduct and national laws of the countries they operate in, especially when it comes to human rights issues (Kokemuller, 2015).

Corporations do not have enough incentives to adopt codes of conduct. International provisions and national laws offer little or no protection to companies that follow ethics Thus, while UNODC, World Bank, OECD members and the United States in particular have urged corporations to adopt a common code of conduct, they have been resistant to do so due to the disadvantage it would place them at in the business world with other countries who do not commit to ethical practices (Torsello & Venard, 2015).

In spite of the many arguments raised, it seems that the efficiency of codes of conduct in curbing unethical behaviour lies with its integration in the corporate culture and with its optimum communication to the employees.

CONCLUSION

The fight against unethical, corrupt behaviour has become one of the present day social challenges. Society expects integrity, transparency, accountability, professionalism and efficiency from both, public and private actors. As a result, the corporate codes of conduct need to better reflect the present dimensions of corporate responsibility in terms of economic, social and legal requirements, serving both the public and corporate needs.

Codes' efficiency has been under constant scrutiny. Scholars and practitioners alike have raised arguments for and against the adoption of written rules of conduct. This proves that creating a culture where ethics rule is a challenging endeavour. However, if codes of conduct will be drafted according to common international standards and their existence will be mandatory for all corporations around the world, then codes of conduct will become a long-term investment that could help curb corruption and bring economic and social benefits.

References

[1] Ljungdahl, Fredrik (2004). “The ‘Transatlantic Divide’: A Survey of European versus U.S. Corporate Codes of Conduct”. Retrieved at http://www.snee.org/filer/papers/242.pdf.

[2] Ardichvili, Alexandre et al. (2013), “Building Ethical Business Cultures: BRIC by BRIC”. Retrieved at http://www.europeanbusinessreview.com/?p=1930.

[3] Giorgini, Vincent et al. (2015). “Researcher Perceptions of Ethical Guidelines and Codes of Conduct”. Retrieved at http://www.ncbi.nlm.nih.gov/pmc/articles/PMC4313573/. 3

[4] Schwartz, Mark S. (2002). “A Code of Ethics for Corporate Code of Ethics”, *Journal of Business Ethics*, no. 41(1–2), pp. 27–43.

[5] Kaptein, Muel and Schwartz, Mark. (2004). “Business Codes of Multinational Firms: What Do They Say?”, *Journal of Business Ethics*, no. 50, pp. 13–31.

[6] Langlois, Catherine C. and Schlegelmilch, Bodo, B. (1990). “Do Corporate Codes of Ethics Reflect National Character? Evidence from Europe and the United States”, *Journal of International Business Studies*, vol. 21, no.4, pp. 519-539.

[7] Kaptein, Muel and Schwartz, Mark. (2008). “The Effectiveness of Business Codes: A Critical Examination of Existing Studies and the Development of an Integrated Research Model”, 77 *Journal of Business Ethics*, no.77, pp. 111-127.

[8] Stevens, Betsy. (1994). An Analysis of Corporate Ethical Code Studies: "Where Do We Go From Here?", Journal of Business Ethics, no. 13(1), pp. 63-69. Retrieved at https://deepblue.lib.umich.edu/bitstream/handle/2027.42/42514/10551_2004_Article_BF00877156.pdf?sequence=1&isAllowed=y.

[9] Ernst & Young. (2015). *Fraud and Corruption – The Easy Option for Growth? Europe, Middle East, and Africa Fraud Survey*. Retrieved at http://www.ey.com/Publication/vwLUAssets/ey-emeia-fraud-survey/$FILE/ey-emeia-fraud-survey.pdf.

[10] Baker, Mark B. (2007). “Promises and Platitudes: Toward A New 21st Century Paradigm for Corporate Codes of Conduct”, *Connecticut Journal of International Law*, vol. 23, pp.123-163.

[11] Kokemuller, Neil. (2015). “The Disadvantages of a Code of Conduct”. Retrieved at http://www.ehow.com/list_7393499_disadvantages-code-conduct.html.

[12] Torsello Davide and Venard, Bertrand. (2015). “The Anthropology of Corruption”, Journal of Management Inquiry, vol. 25(1), pp. 34-54.

THE CEE COMPANIES, ATTRACTIVE DEALS FOR LEVERAGED BUYOUT TRANSACTIONS?

Brandusa BUZILA
Alexandru Ioan Cuza
University
Iaşi, Romania,
buzila_brandusa_feaa@yahoo.com

Abstract: *Leverage buyout in the CEE region was almost nonexistent to 2003 and limited until 2006, when both the international and local creditors, following the global trend, increased demand for mergers & acquisitions. Private equity investors prefer to investigate the characteristics of companies when select target acquisitions. Our study defines a typology of CEE companies in following criteria: profitability, efficiency, liquidity, leverage, cash - flow generated. This study can be used by investors to identify new investment opportunities in the CEE region. The study results show that on average, the sample analyzed (1428 companies CEE) during 2004-2013 is represented by large companies, profitable, efficient, with positive cash-flows, but indebted and with liquidity issues. Low percentage of investments private equity buyout in CEE (only 3% of all private equity investments in Europe) is determined by the types of companies from this region of development, the high level of leverage recorded during the analyzed period in particular.*

Keywords: *leverage buyout, investment opportunities.*

INVENTORY MANAGEMENT, SERVICE LEVEL AND SAFETY STOCK

Alin Constantin RĂDĂŞANU
Alexandru Ioan Cuza
University
Iaşi, Romania,
alin.radasanu@ropharma.ro

Abstract: *The are many studies that emphasize as a first objective of inventory management to minimize the value invested in inventory because has a direct impact on return on assets. This approach is not fully correct. The actual objective is to determine the value and the mix of inventory that support a high service level for customers and that maximizing the financial performance of companies. Many companies look at their own demand fluctuations and assumes that there are too many variables to predict demand variability. Service level is used in inventory management to measure the performance of inventory policies and represents the probability of not being stock-out and not losing sales. Safety stock is inventory that is carried to prevent stock outs. Safety stock determinations are not intended to eliminate all stock outs, just majority of them. Companies choose to keep safety stock level high as a buffer against demand variability resulting in inefficiencies and high working capital requirements. Safety stock optimization enables companies to achieve savings and increase inventory turns.*