

Corporate governance - new challenges

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Abstract:

This article is devoted to the topic of Corporate Governance with updated news, but does not convey the full range of related issues. The selection deals with violations and circumvention of laws, and ways of solving and preventing fraud. The amendment of the Corporate Governance Code in the Czech Republic is also included, as part of the methodology of the administrative body's work. Part of its intent also includes the role of audit committees in the financial control system in Corporate Governance.

Keywords: Whistleblowing, Corporate Governance, Corporate Governance Code, audit committees, Czech Institute of Directors

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1 Introduction

A number of publications (academic books, articles, studies) have already addressed the issue of fraud in companies and ways to prevent unfair practices. This article states the interesting areas addressed in selected contexts at present and the outlook for the near future.

2 Methodology and Data

For research were used primarily search of selected published sources on the topic, corporate governance.

These sources were research studies, expert articles, legislation, annual report and recommendations of selected institutions. The analyzed data are information about the expected development.

The consequences for the further development of corporate governance will then be assessed with regard to the current situation.

3 Results and Discussion

3.1 Whistleblowing

The term whistleblowing began to be used in the 1970s (Hendrych, 2014). The term whistleblowing denotes the practice of drawing attention to some unfair activity or preventing the negative consequences of these activities (Kopecký, 2020).

Many suspicions of breaking the law or even committing a crime (especially economic crime) cannot be identified or deciphered from the outside. Information from the inside is often the only way to effectively detect a pattern of violation or circumvention. According to corporate fraud detection studies, most internal fraud can be detected thanks to whistleblowers, even more often than through internal audits, managerial supervision and external audits combined. According to the Report to the Nations document: Global Study on Occupational Fraud and Abuse, Association of Certified Fraud Examiners, 2020, the most common ways of detecting internal fraud are through whistleblowers (43%), internal audits (15%), managerial supervision (12%), incidental (5%), accounting checks (4%), external audits (4%). In half of the cases, the whistleblowers are employees, then customers, those remaining anonymous, suppliers and others.

The Member States of the European Union are obliged to implement the new amendment on Whistleblowing into their own legislation by December 2021. The government submitted a bill to the Chamber of Deputies on 9 February 2021 (draft law on the Protection of Whistleblowers). The Chamber of Deputies ordered this proposal to be discussed by the Constitutional Law Committee as the Guarantee Committee and the Committee on Public Administration and Regional Development as another committee. The Constitutional and Legal Committee has not yet considered the proposal. The Committee on Public Administration and Regional Development discussed the bill and issued a resolution on 15 July 2021, recommending that the Chamber of Deputies discuss the bill and approve it as submitted. The further fate of the bill will thus depend on the further legislative process. However, there is a risk that the proposed amendment will not be adopted by 17 December 2021.

What will the bill on the Protection of Whistleblowers bring, which from the introduction of a system for whistleblowing (obligation to establish and properly maintain an internal whistleblower notification system) makes it an obligation in selected companies and organisations? In particular, it is intended to provide legal protection to people who report damage to the public interest that they become aware of at work or in connection with it.

Companies (and organisations) will follow the new rules from 31 March 2022. The new obligations will affect, for example, state organisations, large multinational corporations, but also medium-sized and smaller companies. An internal whistleblower notification system will have to be set up by all companies and organisations with 25 or more employees, as well as employers providing selected financial services on the capital market, regardless of the number of employees. Further also by public contracting authorities, except for municipalities with less than 5,000 inhabitants. These bodies must, for example, designate a person responsible for receiving and investigating whistleblower notifications.

Picture 1 Whistleblower Protection Act (translation from origin)**Whistleblower Protection Act****Obligations**

Obligations for companies arising from the draft law on the Protection of Whistleblowers:

1. Implement the internal whistleblower notification system by 31 March 2022
2. Identify the person(s) concerned
 - receives and assesses notifications, acts impartially
 - instruction on rights and obligations (record)
3. Publish information on the whistleblower notification methods
 - internal notification system + SMEs
 - in a way that allows remote access
4. Allow notification in writing and orally, at the request of the whistleblower in person (max. within 30 days)
5. Notify the whistleblower of the receipt of the notification in writing within 7 days of receipt
6. Assess and notify the whistleblower of the results, in writing within 30 days (can be extended twice)

Penalties

Penalty for breach of obligations under the draft law on the protection of whistleblowers:

Fine up to CZK 1,000,000 or 5% of net turnover.

Examples of offences with companies:

- Failure to prevent retaliation
- Failure to determine the relevant person / Failure to ensure material conditions for him/her
- Non-disclosure of information on whistleblower notification methods
- Failure to provide whistleblower notification
- Failure to ensure a proper assessment of the merits of the whistleblower notification
- Failure to notify the whistleblower
- Failure to ensure that appropriate remedial action is taken / failure to take action within the set deadline

Source: https://www.ey.com/cs_cz/forensic-integrity-services/whistleblowing-teni-donaseni-resi-problemy-a-firme-dokaze-i-znacne-usetrit

3.2 A new methodology in connection with the Corporate Governance Code of the Czech Republic

The original Corporate Governance Code of 2004 (issued by the Securities Commission) was replaced by a new document from 2018, mainly reflecting the activities of the Czech Institute of Directors and Deloitte, which reflected the current state and needs of good corporate governance in the Czech Republic. The new Code is based on the OECD recommendations, but it is set in the Czech legislative environment and respects European directives and banking regulations.

This Code will be followed by the second part—the so-called Methodology of the Work of the Administrative Body from the Czech Institute of Directors, which will be publicly presented by the end of 2021. According to this institute, it will focus on medium-sized and family companies and practically show how to manage the company optimally and effectively. With simple instructions, advice and recommendations, it will help to set, as a practical tool for continuous improvement of your activities in the administration and management of your companies, functional rules for effective business management.

3.3 Corporate Governance, control system, audit committees, open questions

With the establishment of various committees and the focus of their activities in Corporate Governance, audit committees are also becoming a more important part of the financial control system, historically due to increasing demands on the capital markets, especially for companies listed on US stock exchanges. It was further extended in European law (according to the Directive of the European Parliament and the Council of the EU, 2006 and 2014). The specifics of the duties of audit committees for public interest entities are dealt with in European legislation by the Regulation of the European Parliament and the Council of 2014. The legal order of the Czech Republic also defines both public interest entities (Accounting Act, Section 1a) and the duties of audit committees in public interest entities and entities with state ownership (Act on Auditors, Section 44, 44a, 44aa, 44b, 44c). We will choose from the range of requirements for the audit committee, we may already notice some areas and ambiguities that are solved in various ways in practice. E.g.

a close connection to the administration and management of the company is already stated in the Act on Auditors, in Section 44 and 44a.

Legislation in the Czech Republic does not directly define the Audit Committee as a company body, it does not determine its specific position in the structure of company bodies. On the other hand, the possibility of establishing an audit committee as a company body is not prohibited; according to the company's decision, this could be enshrined, for example, in the founding documents or their amendments. In another context, European and Czech legislation sets out the focus of the activities of the Audit Committee and its role in the financial control system. We mention here, for example, the following responsibilities: monitors the effectiveness of internal control, the risk management system; monitors the effectiveness of internal audit, monitors the process of preparing financial statements; in relation to the statutory auditor, recommends the auditor to the audit authority; assess its independence, discuss with the auditor the risks to independence, monitor the statutory audit process, based on the summary report on the auditor's quality assurance system; furthermore, the Audit Committee informs the control body about the result of the statutory audit, decides on the continuation of the statutory audit, and approves the provision of other non-audit services. The expertise of the members of the Audit Committee in terms of their activities is required. The list of duties of the audit committee, as mentioned, is not exhaustive.

Here, however, it is appropriate to mention the importance of cooperation with other bodies in the administration and management of the company, but especially with the supervisory body (Supervisory Board) and the Board of Directors. On one hand the "information obligations" of the Audit Committee, which are passed on by the Audit Committee from internal controls, accounting and financial statements, the audit process, auditor selection and so forth are evident, and on the other the Board of Directors and the Supervisory Board should be more interested in, for instance, joint meetings. In all cases, mutual activity and initiative are encouraged.

Where can data on the fulfilment of requirements for the activities of audit committees, information on cooperation with top corporate governance bodies in the world and in the Czech Republic be drawn? A clue to obtaining a basic overview of information, especially for public interest entities, can be found in various analyses, annual reports, which are mostly prepared in the form of questionnaires intended for audit committees. An example are the supervisory authorities (Committee of European Audit Oversight Bodies, CEAOB and the Council for Public Oversight of Audit in the Czech Republic). In their published annual reports, the answers from the questionnaires on the activities of the audit committees are processed (the answers are basically only in the form *Yes, No, not significant*), and are supplemented by a clear graphic representation. For specific forms in which the Audit Committee proceeds, e.g. in the obligation to monitor the effectiveness of internal monitoring checks, the effectiveness of internal audit and other activities listed, see above. However, the fact that the given audit committee answers in the questionnaire that it monitors and assesses, i.e. *Yes*, does not express the methods, scope, evaluation. This is already in the hands, so to speak, of the internal procedures established by the audit committee.

These questionnaires are criticised for containing more self-assessment of audit committees and the interpretation of their conclusions is limited. An example are the conclusions made based on a questionnaire prepared by the CEAOB, which pointed out the need for more thorough monitoring of the communication of audit committees with both auditors and the company's top bodies. A tender for an audit engagement is also mentioned as a problematic area.

The conclusion of the Annual Report of the RVDA in the Czech Republic for 2020 mentions an important role for 2021, i.e. focusing on monitoring the activities of audit committees,

cooperation with foreign supervisory authorities and monitoring current developments in activities and requirements for audit committees on an international scale.

4. Conclusion

Even in the Czech Republic, trends in the need for good Corporate Governance continue. The methods of inspections are expanding, both externally and also within the set internal procedures. "Whistleblowers" have an important role to play. Based on the OECD recommendations, the innovations are also implemented in the Corporate Governance Code in the form of functional rules for effective corporate governance. What will be the specific legislative measures and their application in the Czech Republic will certainly be of interest to the general public.

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