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Financial System, Audit and Corporate Governance During and After the Financial Crisis

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Abstract
A financial system is a set of institutions, such as banks, insurance companies, and stock exchanges, that permit the exchange of funds. Financial systems exist on firm, regional, and global levels. Borrowers, lenders, and investors exchange current funds to finance projects, either for consumption or productive investments, and to pursue a return on their financial assets. The financial system also includes sets of rules and practices that borrowers and lenders use to decide which projects get financed, who finances projects, and terms of financial deals. The concept of "internal control" conveys a difficult and complex process. Different countries have different interpretations of the internal control system, and in accordance with their tradition use different methods, techniques and philosophies for its implementation.The financial system of our economy, although it must be acknowledged that it is not very modern and developed, is still quite complex. In support of a complete system with all components, there is a need for harmonized investment in many directions at once. Financial crises and stock market crashes have clearly demonstrated the impact of investors' sentiment on asset pricing and stock markets' efficiency. Herd behavior, which is behavioral similarity based on individuals' interaction that leads to convergence of action and correlated trading (Hirshleifer and Teoh, 2003), is one of the most important behavioral biases that is more likely to occur during periods of market stress when individual investors prefer to follow the market consensus, being reluctant to follow their own knowledge or beliefs (Christie and Huang, 1995). Management on all levels must have full confidence in the integrity and independence of the audit process.Financial system, audit and corporate governance (CG) has come to the forefront of academic research due to the vital role it plays in the overall health of economic systems. The wave of U.S. corporate fraud in the 1990s was attributed to deficiencies in corporate governance. The recent 2008-2009 global financial crisis, triggered by the unprecedented failure of Lehman Brothers and the subprime mortgage problems, renewed interest on the role of corporate governance in the financial sector. The main purpose of this scientific paper is to study financial situation, audit and governance and strategies for optimizing investment, concretelly in the albanian financial environment.
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1.Introduction

The financial system is a very important element for every economy and everywhere is considered as a catalyst where economic developments in a given country follow the shape and proper form. It is considered important because its development has affects in the performance and economic stability. Financial markets have the object of trading some instruments, negotiating of other rights or different kinds of products that we call financial products or financial instruments (FI). Financial markets are an important means by which savings, public or private, are transformed into productive investments.In most Albanian and foreign economic environments, more and more current issues of the level of development of financial system and its role in accelerating the economic development country's. One of the most important issues is to determine at what stage of development is the financial system and the conditions for its further development are met. The Albanian economy is nowadays introduced as a new market economy, which is moving from the stage of birth to the growth stage.The financial system, conceived as a community of institutions, markets and financial instruments, has had relatively positive developments over the past 20 years, facing many challenges and difficulties in the way of its perfection and consolidation. Some financial system links, such as banks, seem to be moving faster and represent the most developed sector in the country. On the other hand, the country has a non-banking sector, still in the early stages of development with sub-sectors, which do not have the same development pace. The system of non-subsidized institutions has begun to develop and they need a greater development. In these institutions we can mention insurance companies, pension funds and investment funds. The most underdeveloped part of our financial system is the share of capital markets and the share of the stock exchange (se).Within the level of development lies the role played by the financial supervision system in function of the development of financial markets, national and wider. Regulation and supervision are two of the most important functions of the financial supervisory authorities, through which these

authorities achieve their objectives. Establishing financial stability is the common goal of both regulation and financial oversight by the Albanina Financial Supervisory Authority and the Central Bank (BOA). The supervisory should aim to protect the sustainability of financial system's, while also providing consumer protection.Financial crises are characterized by the sharp contraction of the bank lending. During the times of financial crisis, the banks become more reluctant to lend, exacerbating the financing constraints. In turn, firms cut investments in capital and R&D and are more likely to bypass attractive investment projects (Campello et al., 2009). In a systemic financial crisis, liquidity shocks experienced by some firms might be transmitted to other firms via supply credit chains. The existing theoretical models (e.g., Cunat, 2007; Wilner, 2000) only deal with a single customer's distress event, rather than a systemic shock that might affect all suppliers and customers alike. During such crisis times, the supply chains might instead propagate and amplify the liquidity shocks, as argued by Raddatz (2009).Corporate governance is a central and dynamic aspect of business. The importance of corporate governance for corporate success as well as for social welfare cannot be overstated. Examples of massive corporate collapses resulting from weak systems of corporate governance have highlighted the need to improve and reform corporate governance at the international level. The numerous agency theory-based studies dominate the research on corporate governance. Their economic focus has made them very popular for practitioners to interpret the quality of governance practices (Raelin & Bondy, 2013).Consequently, corporate governance has become one of the most commonly used phrases in the current global business vocabulary. The notorious collapse of Enron 2001, one of America's largest companies, has focused international attention on company failures. In addition, it also presents the role that strong corporate governance play in preventing these failures. "Corporate governance" comprises of a country's private and public institutions, both formal and informal, which together govern the relationship between the people who manage corporations (corporate insiders) and all others who invest resources in various corporations in the country. A number of studies on corporate governance have adopted the comparative research methodology, mainly with the purpose of building cross-cultural and cross-national corporate governance knowledge (Aguilera, 2005; Aguilera & Jackson, 2003, 2010; Filatotchev et al., 2013).

2. Literature review for various modern financial model, financial system in Albania and abroad.

Corporate risk disclosure represents and important, specific category of corporate disclosure.

Although in Albania the free market reforms date from the 90s, the financial market is in the incubation phase. The country went into a deep crisis due to Ponzi schemes in the late nineties, which made people distrustful of investing their money. With the transition to the market economy, it gained great importance the transformation of our financial system. Reforming the financial system assumes great importance in macroeconomic stability. Everything the countries, which have had this transformation as their objective, have aimed the creation of a two-level banking system, the increase in the rate of autonomy of the central bank, increased competition in the field of banking system. The Law "On the Bank of Albania" aims to ensure independence institutional, real and formal of the central bank in function of its main objective, while the law "On banks in the Republic of Albania" aims to build a complete regulatory system e supervisor of banks. The drafted regulatory framework is being developed increasingly based on international standards classification of loans, creation of reserve funds, rates adequacy of capital, liquidity, position foreign exchange etc..Webster & Watson 2002, consider reviewing literature more than merely an analysis of scientific works summaries. Markowitz (1952) proposed the average-variance methodology for the shares that serve as a basis for the development of the modern finance theory over the past decades. Markowitz's average-variance basis is to get the expected profit of an action such as gaining an investment and the variance of an action as the risk of an investment. The Capital Asset Pricing Model (CAPM), a widely used finance model for calculating the cost of capital and portfolio performance, identifies the riskiness of assets. CAPM has been developed by Sharpe (1964), Lintner (1965) and Moss (1966), and the model has gained a considerable popularity in the price of risky financial assets. In this model, the asset's risk is measured by the beta coefficient and the risk risk per unit of risk is constant across all assets. In addition, the CAPM has a linear link between the expected asset risk premium and the beta market that can be defined as a systemic risk and CAPM claims that expected return on assets may change as the beta market asset values are not similar. The average-variance model (MV) has been modified in literature in many ways. Such a job is the market model, or the only model whose index ignores covariance between securities returns (Sharpe, 1964, Lintner, 1965). The Single Index model considers that securities returns depend only on a market index and covariances between assets are not needed. This further led to the development of the Capital Asset Pricing Model (CAPM).

Tabela.1: The structure of Financial System in Western Balkan States

	ALB		BiH		MKD		KOS		MNE		SRB	
	No.	% of total assets	No.	% of total assets	No.	% of total assets	No.	% of total assets	No.	% of total assets	No.	% of total assets
Commercial banks	**16**	**90.3**	**26**	**86.3**	**15**	**86.8**	**10**	**70.3**	**12**	**87.6**	**29**	**91.8**
Private	16	90.3	24	83.9	14	83.6	10	70.3	12	87.6	23	74.1
Domestic	2	11.7	8	5.9	2	3.4	2	6.7	5	18.0	2	5.8
Foreign	14	78.7	16	78.0	12	80.2	8	63.6	7	69.7	21	68.3
State-Owned*	-	-	2	2.4	1	3.3	-	-	-	-	6	17.6
Other depository institutions (savings and loan associations)	**126**	**0.7**	-	-	4	0.6	-	-	-	-	-	-

Source : World Bank (2015)

3.Wy is good corporate governance important?
Policy makers, practitioners theorists have adopted the general stance that corporate governance reform is worth pursuing, supporting such initiatives as splitting the role of chairman/chef executive, introduction non-executive directors to boards, curbing executive, introducing non-executive directors to boards, curbing excessive executive performance -related remuneration, improving institutional investor relations, increasing the quality and quantity of corporate disclosure, *inter alia*.

Corporate ownership structure has been considered as having the strongest influence on systems of corporate governance. Corporate governance is defined as the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity.

Separation of ownership and control in a large stock cooperation would be of no particular consequence if the interests of owners and managers coincided. There are, however, reasons to believe that these interests may diverge. Firstly, managers tend to be influenced by a range of consideration -such as the size of the corporation or the power and prestige associated with their position – which bear no relation to shareholder interests. These consideration may lead them to decisions such us, for example, corporate empire building-which not only do not benefit shareholders but possibly hurt them. Second, the financial rewards of managers and owners differ. Managers are traditionally guaranteed a remuneration paid in the form of salaries whereas shareholders are merely entitled to residual earnings of the firm after all other obligations have been met.

4.The collapse of corporate during the finance crisis.
In 2001 Enron become a household name – and probably in most households in most countries around the world! On 2 December 2001 Enron, one of the 10 largest companies in the USA. Enorn was a Houston – based energy company founded by a brilliant entrepreneur, Kenneth Lay. On the 2 December 2001, the great Enron filed for Chapter 11 bankruptcy. Kenneth Lay resigned in January 2002. The fall of Enron was the biggest corporate collapse ever, and the downfall of Andersen the most significant death of an accounting firm ever. Overall, corporate governance in Enron was weak in almost all respects. The board of directors was composed of a number of people who have been shown to be of poor moral character and willing to conduct fraudulent activity. The internal audit committee did not perform its functions of internal control and of checking the external auditing function. Furthemore, the company's accounting and financial reporting function failed miserably. Both the financial directors and the chief executives were prepared to produce fraudulent accounts to the company.

The financial crisis changed the consensus on the adequacy of traditional bank regulation, which focused on the solvency of a single institution. The basic insight is that the banking system can "run on itself", because of a lack of trust between financial institutions. The old system assumed that the health of banks was adequately captured with risk-based regulation, which turned out to be false. When the losses mounted, it turned out that potential losses were severely underestimated. Moreover, it became quite hard to assess which bank was solvent and which was not. The financial position of multiple banks was threatened at the same time: a systemic crisis.Corporate governance refers to the entire system for managing and supervising a company. Corporate Governance is a broad term defines the methods, structure and the processes of a company in which the business and affairs of the company managed and directed. Corporate governance is the system by which business corporations are directed and controlled.A number of studies on corporate governance have adopted the comparative research methodology, mainly with the purpose of building cross-cultural and cross-national corporate governance knowledge (Aguilera, 2005; Aguilera & Jackson, 2003, 2010; Filatotchev et al., 2013). The process carried out by the board of directors, and its related committees, On behalf of and for the benefit of the

company's Shareholders and the other Stakeholders, to provide direction, authority, and oversights to management, "It means how to make the balance between the board members and their benefits and the benefits of the shareholders and the other stakeholders" (M.Tarek Youssef, 2007).Effective corporate governance requires a clear understanding of the respective roles of the board, management and shareholders; their relationships with each other; and their relationships with other corporate stakeholders. On the 2nd of December 2001, Enron became one of the 10 largest companies in the USA. In the following months, more and more evidence emerged about the weaknesses and fraudulent activity of corporate governance. However, countries across the world have been unsettled and disturbed by the shock of this event and are now examining their own corporate governance systems in micro-detail. This they do by looking for similar weaknesses and potential like Enrons. *Enronitis* has spread across the globe like a lethal virus, infecting every company and every shareholding institutions. In addition, it also had a significant effect on worrying even by the smallest shareholder and unnerving the financial markets.Enron was a Huston-based energy company founded by a brilliant entrepreneur, Kenneth Lay. The company was created in 1985 by a merger of two American gas pipeline companies. Within a period of 16 years, the company was transformed from a relatively small concern, involved in gas pipelines, and oil and gas exploration, to the world's largest energy trading company (The Economist, 28 November 2002). Enron, the champion of energy deregulation that grew into one of the nation's 10 largest companies, collapsed yesterday. This collapse occurred after a rival backed out of a deal to buy Enron, and after many big trading partners stopped doing business with the company.Enron, based in Houston, has been widely expected to seek bankruptcy protection. With $62 billion in assets as of September 30, it would be the biggest American company ever to go bankrupt. Hence, this company dwarfs the filing by Texaco in 1987. Late in the day, Enron's chief financial officer, Jeff McMahon, stated that the company was still talking to banks about a restructuring and a consideration of other options.The role of a company's board of directors is to oversee corporate management in order to protect the interests of shareholders. However, in 1999, Enron's board waived conflict of interest rules to allow chief financial officer, Andrew Fastow, to create private partnerships to do business with the firm. These partnerships appear to have concealed debts and liabilities that would have had a significant impact on Enron's reported profits. Subsequently, Enron's collapse raises the issue of how to reinforce the directors' capability and will to challenge questionable dealings through corporate managers. Several corporate governance problems have emerged due to Enron's wreckage. Unfettered power in the hand of the chief executive is an obvious problem, and is one that characterized Enron's management. Also, there were numerous illustrations of unethical activity within the Enron organization that continued to come to light long after its downfall. For example, in May 2002, it became clear from the documents released by the Federal Energy Regulatory Commission that Enron's energy traders developed and used strategies or tricks to manipulate the markets where Califonia bought electricity. Overall, corporate governance in Enron was weak in almost all aspects. Thus, the board of directors is composed of a number of people who lacks moral character. Also, they are often willing to engage themselves in fraudulent activity. This was the genuine root of the company's corporate governance failure. There has been a proliferation of books on the downfall of Enron, seeking to explain why events transpired as they did. As we have seen, the USA and the UK strong reaction to Enron's collapse and corporate governance has been hurled to the center stage. This occurs as a result of the weaknesses at the heart of Enron's corporate governance system. The long- term effects of Enron will hopeful be a cleaner and more ethical corporate environment across the globe. Furthermore, the continuous updating of corporate governance codes of practice and systematic review of corporate governance checks and balances are necessary to avoid other Enron's in the future. Clearly, corporate governance check and balances can only serve to detect, not cure, unethical practices. A complicating factor in issues of fraud and ethical breakdown is the intangible nature of fraud. In addition, there is a grey area surrounding what is *right or wrong, good or bad* in human behaviour. Some comments made by Sheldon Zenner, an American white-collar criminal and civil lawyer, when speaking of the Enron trial, helped to illuminate this issue. Separation of ownership and control in a large stock corporation would be of no particular consequence if the interests of owners and managers coincided. Corporate governance is concerned with overcoming the problems of the monitoring and controlling of managerial performance. This occurs whenever corporate ownership and corporate control are separated as a result of dispersed share ownership. The primary function of corporate governance is to ensure that companies are runned based on the interests of corporate shareholders. However, these shareholders provide financial resources in running them. In the UK and US, owners of typical corporation are many, and their shares are small relative to the size of the corporation. According to agency theory, corporate governance is the set of instruments that owners deploy to make sure the company is managed according to their interest (Huse et al., 2007). The collapse of Enron during 2001 has brought about a focused attention on the effectiveness of the non-executive director function. The corporate board, with its mix of expertise, independence, and legal power, is a potentially powerful governance mechanism. As in the case of Enron, the failure of Parmalat to establish careful checking and monitoring structures within the company's governance framework laid it bare to the abuse of power and fraudulent activity. Unless these devices for detecting fraud and misconduct are in place, it is relatively easy for Enron-like situation to arise. Parmalat was owned by a complex group of companies, controlled by one strong blockholder (the founding Tanzi

family) through a pyramidal structure (see Melis,2005). Although italian corporate governance is characterized by monitord, namely the statutory auditors and the external auditing firm, these did not manage to protect the company from self- destruction.

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5. Responsibilities for the functioning of internal control in an organization.

Within a company's system of internal control, the external audit represents one of the most indispensable corporate governance checks and balances thet help to moniotor comany managements activities, thereby increasing transparency.From the agency theory perspective, the audit functions represents another important corproate governance mechanism that helps sheareholders in their monitoring and control of company management.The academic literature has provided mixed evidence on the effectiveness of the audit functions, with respect to whether the audit adds value for investors and whether auditors'actions are indipendent of client interests (Healy and Palepu, 2001).Estabilishing audit committees and developing effective accounting standards were suggested as the most apt means of ensuring this balance is attained. A successful internal control program depends on the participation of all employees at every level. Competence and professional integrity are essential components of a sound internal control program.

Management is responsible for establishing internal controls. In order to maintain effective internal controls, management should:

1. Maintain adequate policies and procedures;
2. Communicate these policies and procedures; and
3. Monitor compliance with policies and practices.

There are generally several major groupings on the issue of defining internal control, which come from: IFAC, INTOSAI, the COSO model and the EU model and best practices. Basically these definitions do not represent radical changes. Since the countries of Western Europe, where both our countries belong, aspire to join the EU, we are quoting the definition of internal control according to the model and practices of the EU, which is as follows:

> *Internal Control (IA) is an integral process of the Financial Management and Control (FMC) system, as well as Internal Audit (IA), set by the head of the public organization, within its governing objectives, to assist in the performance of activities of the public entity with economy, effectiveness and efficiency.*

> "The variety of internal control system in EU Members states; the Commision's analysis of exsisting public control systems in applicant countries; the lack of a common concept releting to internal control, internal as well as external audit; developing a strategy for supporting applicant countries in accordance with guidelines developed by SIGMA, the IIA, COSO model and INTOSAI.[1]

6.Financial risk and governance of public companies in Albania. Analytical model.

As a result of increasing interest in corporate governance matters within the practitioner community, academic research has burgeoned in the area.

During a financial crisis episode, such 'liquidity shock chains' can operate in reverse. Firms that experience tightening financing constraints as a result of bank credit contraction may withdraw credit from their customers. Thus, they pass the liquidity shock up the supply chain – that is, their customers might cut the credit to their customers, and so on. The firms that are privileged enough to have access to outside finance, that is, the 'deep pockets' (Boissay and Gropp, 2007), might be the ones that are most severely affected by the crisis. After all, if a firm does not have bank finance to start with, the banking crisis will have little direct effect on their financial condition. The suppliers to financially constrained firms may also reduce the trade credit that they extend either because they are financially constrained (if the liquidity shocks are highly correlated) or because they choose to withdraw credit from their less creditworthy customers. Thus, the supply chains might propagate the liquidity shocks and exacerbate the impact of the financial crisis. Albania is a country in the transition economy. Corporate governance is in the its beginning. In some developed countries, state-owned companies continue to represent a significant proportion of GDP, employment, and market capitalization. Corporate governance in the public sector is undoubtedly a very important challenge in many economies of different countries for its complexity. Public companies in many countries find them in important areas such as transport, telecommunications, energy, etc. Corporate governance in the public sector is critical to ensure their positive contribution to the overall competitiveness of a country and economic efficiency. The good governance of state-owned enterprises is a prerequisite for effective privatization, as it would make them more attractive to the buyers and more effective and it could increase their value.

[1] Public Internal Financial Control-PIFC, Robert de Koning, January 2007.

In our analyze there are 4 cases from various companies, concretely financial institution from 76 companies that has analyzed.

Case 1.The financial risk and corporate governance measurement.

The value of the Pearson Chi Square coefficient in the table below is = 4.824. This value is not significant as p = 0.567> 0.05. This value in the case below is not important because it results not within the appropriate static parameter (p <0.05).

	Value (Vlera)	df	Asymp. Sig. (2-sided)
Pearson Chi-Square (Hi-katror i Pearson)	4.824[a]	6	.567
Likelihood Ratio (Koeficienti i Përgjasise)	5.067	6	.535
Linear-by-Linear Association	.977	1	.323
N of Valid Cases	76		

a.8cells (66.7%) have expected count less than 5. The minimum expected countis.16.

Case 2.The financial risk and financial crisis.

The value of the Pearson Chi Square coefficient in the table below is = 0.388. This value is not statistically significant since p = 0.534> 0.05 indicating that we have no relation between the above variables. The test did not prove satisfactory.

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	.388[a]	1	.534
Continuity Correction[b]	.000	1	1.000
Likelihood Ratio	.653	1	.419
Fisher's Exact Test			
Linear-by-Linear Association	.383	1	.537
N of Valid Cases	76		

a. 2 cells (50.0%) have expected count less than 5. The minimum expected count is .28.

b. Computed only for a 2x2 table

Case 3. The financial crisis and corporate governance.

Financial crisis discloses functional and/or institutional asymmetries in the economy and requires structural action to achieve a sustainable recovery and economic growth. This was the case with the Bulgarian financial crisis of 1996–97, as well as with the global financial crisis in 2007–08 year.

One of the most important conclusions from the Bulgarian financial crisis was not only the need for fiscal consolidation, but clearly outlined the need for deeper structural reforms—economic restructuring, accelerating the unfinished privatization of state assets, streamlining of the government spending.

The value of the Pearson Chi Square coefficient in the table below is = 14,739. This value is wholly meaningful as p = 0.005 <0.05. We point out that this value in the case below is significant because it results within the static parameter (p <0.05), indicating that we have links between the above variables.

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	14.739[a]	4	.005
Likelihood Ratio	17.739	4	.001
Linear-by-Linear Association	4.394	1	.036
N of Valid Cases	76		

a. 4 cells (44.4%) expected to count less than 5. The minimum expected count is .71.

This value is significant when p <0.001. in this case it is completely so, so it matched.

The test was completely satisfactory and with a full connection.

Case 4. The financial crisis,audit and financial system.

The value of the Pearson Chi Square coefficient in the table below is = 14,769. This value is wholly meaningful as p = 0.005 <0.05. We point out that this value in the case below is significant because it results within the static parameter (p <0.05), indicating that we have links between the above variables.

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	14.769[a]	4	.005
Likelihood Ratio	17.769	4	.001
Linear-by-Linear Association	4.394	1	.036
N of Valid Cases	76		

a. 4 cells (44.4%) expected to count less than 5. The minimum expected count is .71.

This value is significant when p <0.001. in this case it is completely so, so it matched.

The test was completely satisfactory and with a full connection.

7.Conclusion

Albania is a small country with a limited capital market, where the further development of this market is thought to be difficult due to bureaucracies and the lack of a standardized legislation according to EU countries, as well as the presence of information asymmetry in this market. Under these conditions, it would be better to try to develop a regional or segmented exchange of a group of Albanian companies in one of the stock exchanges of the countries of the region. This would be worth absorbing the experience from these countries and opening a diverse range of financial securities trading.Financial crises of the 2007–08 kind, in the largest economy of the world, do not happen without any early warning signs, whatsoever. It may not be an anachronism to say that the financial crisis of 2007–08 in the United States should have occurred prior to 2005. Evidence was the massive amounts of refinancing of residential mortgages in the United States, right after what appeared to be the peak of a housing price bubble around December, 2004. Like the American cases, the Parmalat scandal has raised questions about how the company could fudge its numbers for so long without any help from outside. The auditors, says Mittelstaedt, should have least spoken to Bank of America to verify that they held the $4.9 billion Parmalat claimed. The system of checks and balances that support corporate governance needs to function effectively. Consequently, both Enron and Parmalat highlight the essential functions of non-executive directors, audit and disclosure, as well as ethicality of management. Corporate governance mechanisms cannot prevent unethical activity by top management. However, they can at least act as a means of detecting such activity by top management before it is too late. When an apple is rotten, it has no cure. Nevertheless, the rotten apple can be removed before the infection spreads and infects the whole barrel. Therefore, an analysis of the Enron and Parmalat cases shows that both the US and corporate governance systems are so different in character. Additionally, they can be vulnerable to abuse and corporate governance weaknesses which are similar in nature. This is really what effective corporate governance is all about. Therefore, this study aims to explore the various checks and balances, and mechanisms by which good corporate governance ensures successful business and social welfare maximization.

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