



# THE LEGISLATIVE DECREE 231/2001 ORGANISATIONAL MODEL A POTENTIAL CONTROL TOOL FOR LOCAL PUBLIC GROUPS

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## **Abstract**

The purpose of the paper is to ascertain whether the implementation of an organisational model similar to the model defined in Legislative Decree 231/2001 may be a valid control tool for public companies which include other shareholding companies, defined as local public groups. The paper is developed, through the tracing and study of all the documentation concerning the organisational models of the subsidiaries of Comune of Turin, taken as part of the sample and the relative subsidiaries: in particular the consolidated financial statements of the group and the financial year of the relative subsidiaries, the reports about corporate governance, the organisational models in 231/01 and the codes of ethics. The study of the abovementioned documentation has made it possible, partly through a deep analysis of the scientific contributions present on the subject, to develop a questionnaire/interview to submit to the parties who act as contacts on the board of directors of the groups sampled normally identified in the Internal Audit function. The research highlights the need to adopt specific techniques and instruments that are suitable for identifying and analysing all risks that could concern the group of local public companies. It emerges in fact that Italian local public companies invest in systems to monitor performance and compliance, trying an integrated approach at group level. The objective is in fact the transversal and exhaustive nature of risk evaluation that leads to models of group organisation that are efficient and effective. Efficient, in such a way that the costs of managing the system are less than the benefits obtained in terms of risk coverage; effective in as much the organisational models integrated at group level increase the protection of the administrative and criminal accountability of the entire company group. An unitary organisational model thus involves an integrated internal auditing system that must be well established inside the group of public local companies.

Keywords: Corporate Governance and Accountability, Auditing and Assurance, Italy

# 1. Introduction<sup>1</sup>

In the past only a few of the major Italian companies spontaneously adopted selfregulatory tools such as codes of corporate conduct or codes of ethics. As a reaction to national corporate scandals such as those involving Cirio and Parmalat, things started to change as the need for corporate governance reforms was felt at the institutional as well as at the corporate level.

In particular the legislative, decree 231/2001<sup>2</sup> has introduced the culture of internal checks in companies as a prevention of offences, into Italy. The regulation imposes sanctions on companies as legal entities responsible for not having prevented its employees from committing offences in the interests of the company (offences against the public administration, IT offences, offences against safety in the work place, false declarations in the financial statements etc. ). These are large monetary sanctions , the closing down of businesses in the case of recidivism, prohibition against dealing with the public administration as a precautionary measure. The law does not provide for a mechanism of credits or certifications for consulting firms that should support companies in the implementation of 231; on the contrary it requires companies to take part in the organisation and to produce paper documentation showing a mapping and reengineering of internal processes, integrating them with a system of operational risk prevention and control.

In this context the central place occupied by the subject of governance, or rather the collection of rules and mechanisms through which the equilibrium between the expectations and the contributions of the various parties involved in the life of the company is understood. [Airoldi, 1996]

Starting from a prospective of research focused on the analysis of the characteristics and the functioning of the boards of directors and the other organs of government within corporate groups, this paper proposes a framework for the analysis of the systems of governance, with the aim of highlighting similarities/differences and models of best practices to tend towards in the choices of governance adopted by the corporate groups, with particular attention to the implementation of the organisational model provided for by legislative decree 231/01 and the influences that the same may have on the regulation of infragroup relations.

## 2. Literature Review

The principles of governance in the public sector are the policies, processes and structures implemented by an organisation to direct and control its activities, attain its objectives, and protect the interests of different groups of stakeholders in an ethical manner [Puddu, 2006].

In order to create local public groups, in which companies (public, private or mixed) are controlled by the local “municipality”, three distinctive elements are necessary, as per the following:

- a public economic entity; even if this does not exclude an important role for “private” companies; in particular, the entity may be a single entity or made up of an alliance of municipalities or other local entities, that in terms of territorial and political characteristics, share the production means for public utility services;

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<sup>1</sup> Simona Alfiero is to take credit for paragraphs 1, 2 and 3; Silvana Secinaro for paragarphs 4 and 5.

<sup>2</sup> An integral test of Legislative Decree 231/2001 is available at:  
<http://www.parlamento.it/parlam/leggi/deleghe/01231dl.htm>.

- a number of different types of legal entity; bearing in mind that the specific nature of the public group is that it comprises companies of a private and public nature;

- a single financial and strategic management team, an aspect which is typical of any group of companies, but which in this specific case is accompanied by the peculiarity of financial and strategic decisions related to the public function of the local entity.

The different needs and existing situations which are the basis of the creation of a local public group determine different configurations in organisational and managerial terms, which may be outlined and refer to the following three models:

- “traditional” groups;
- “mixed” groups;
- “empirical” groups.

In the traditional model, the group is structured on two levels, with only one management and coordination centre where the municipality is a real holding. However, in this case there is the anomaly of a group of private companies, that work in different segments of a competitive market, that are subsidiaries of a parent company operating in accordance with the logic and administration timescales of the public sector.

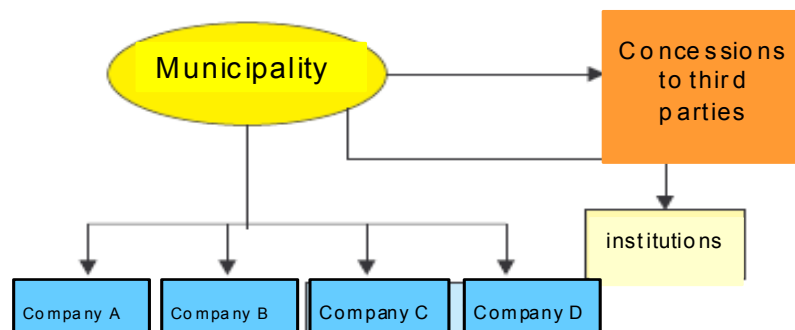


Figure 1. “Traditional” groups. Source: [Developed by the authors]

In the model which can be defined as being mixed, the municipality only reserves the right to act as the proprietor, while the holding has responsibility for coordination and management of subsidiaries. However, this approach is only applicable to companies limited by shares, the services provided remaining under the direct control of the entity through any other defined legal form.

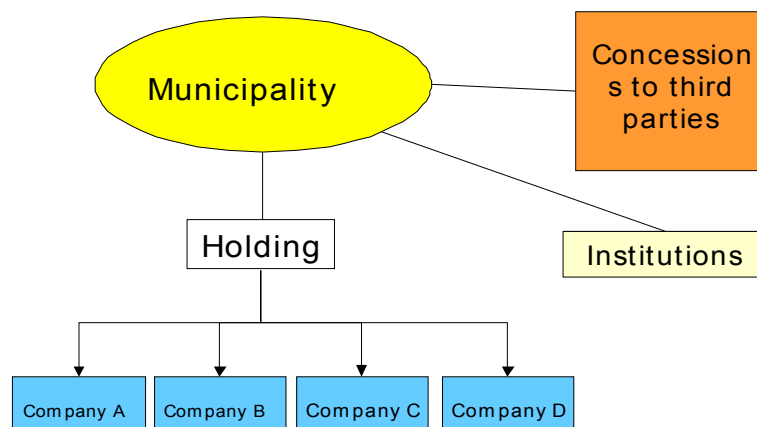


Figure 2. "Mixed" groups. Source: [Developed by the authors]

In many cases groups are organising themselves as "empirical" structures, differentiating the logic of their structures not only on the basis of the type of service they provide, but also the different structures they wish the group's shareholding to take.

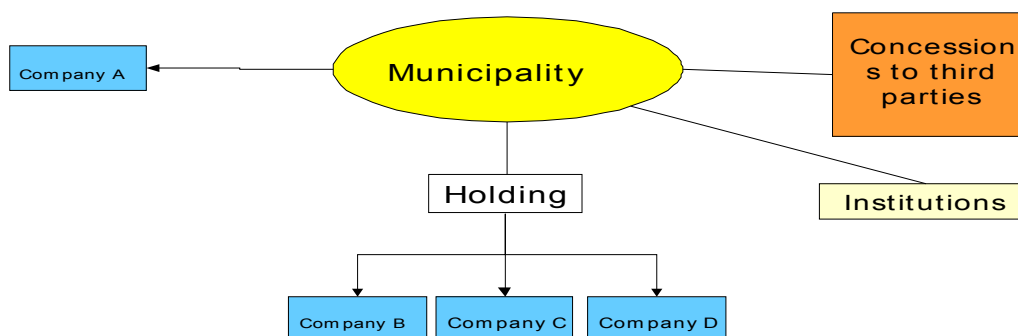


Figure 3. "Empirical" groups. Source: [Developed by the authors]

The concept of control in accordance with article 2359 of the Italian Civil Code<sup>3</sup> is not sufficient, since it would limit the units that need to be consolidated only to the companies limited by shares that the local entity has shares in.

The factors based on which it is possible to claim the existence of a control situation are the following:

<sup>3</sup>C.c. 2359. Subsidiaries and affiliated companies.

The following are considered subsidiaries:

- 1) companies in which another company has the majority votes in ordinary meetings;
- 2) companies in which another company has enough votes to be a dominant influence in ordinary meetings;
- 3) companies that are subject to the dominant influence of another company because of particular contractual obligations.

For the purpose of applying numbers 1) and 2) of the first paragraph the votes that subsidiaries, trust companies and interposed persons are entitled to are also included: votes to which third parties are entitled are not included.

Companies in relation to which another company exercises a notable influence are considered affiliates. The influence is assumed to be applicable when at least a fifth of the votes, or a tenth if the company limited by shares is listed in the stock exchange, can be cast in ordinary meetings.

- the identification of persons appointed to positions in the management organs of subsidiaries;
- a dominant influence when approving the main planning and control tools regarding corporate results;
- the ownership of voting rights that are sufficient to influence resolutions in the meetings of companies limited by shares, special companies and consortiums in which a number of local entities have shares.

The management aspect emerges along with the aspect of governance: the question is how control of the management of a municipality affects the management of the group, and whether or not the criteria used to prepare the balance sheets is uniform

The group member carries out an action with respect to the other members of the group which is variable due to the distance from the local organs set up for management purposes, the instruments employed in the exercising power of an economic nature as well as for the intensity and the direction of the influence exercised, with regard to the particular objectives to be pursued. In particular the instruments are influenced by the guidelines that mainly go through the corporate lines of governance defined by the organs, by the people involved and by the procedures that codify the guidelines into concrete managerial actions. It is scientifically and empirically proven that the corporate groups, by adopting mechanisms of communication and control that involve the management of the group, overcome the barriers placed by legal limits on individual units.

On the other hand, if we consider the better known “four dimensions of integration”<sup>4</sup>, that summarise the motivational aspects correlated with the existence of a group, i.e. reciprocity, opportunism, expectations and faith, we notice that the sharing of the risk, the exchange of technologies, the rationalisation within the group have common bases of understanding for the development of the group itself (reciprocity). From another point of view, however, opportunism, according to which each subject tends to favour his own interests, it can create serious prejudices at the level of group co-ordination and expectations each entity places in the group and mutual trust. Opportunistic behaviour, regardless of the way in which it manifests itself, produces important consequences: it could induce the increase in the cost of a transaction between the companies with the risk of compromising any economy-of-scale-related benefits. The consequence is the increase in the costs of control since the companies are obliged to dedicate more energy to the monitoring of other people’s conduct. Furthermore the opportunism increases the risk of conflict while reducing the co-ordination of the group.

### 3. The Objective of the Research

The objective of the research is that of ascertaining whether the implementation of an organisational model similar to the model defined in Legislative Decree 231/2001 may be a valid control tool for public companies which include other shareholding companies, defined as local public groups.

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<sup>4</sup>The four dimensions of integration have been theorised by A. Parche, in “Messy” research, mythological predisposition and theory development in international joint ventures, in *Academy of Management Review* 1980

## 4. Methodology of the Research

The analysis is developed, through the tracing and study of all the documentation concerning the organisational models of the subsidiaries of Comune of Turin, taken as part of the sample and the relative subsidiaries: in particular the consolidated financial statements of the group and the financial year of the relative subsidiaries, the reports about corporate governance, the organisational models in 231/01 and the codes of ethics

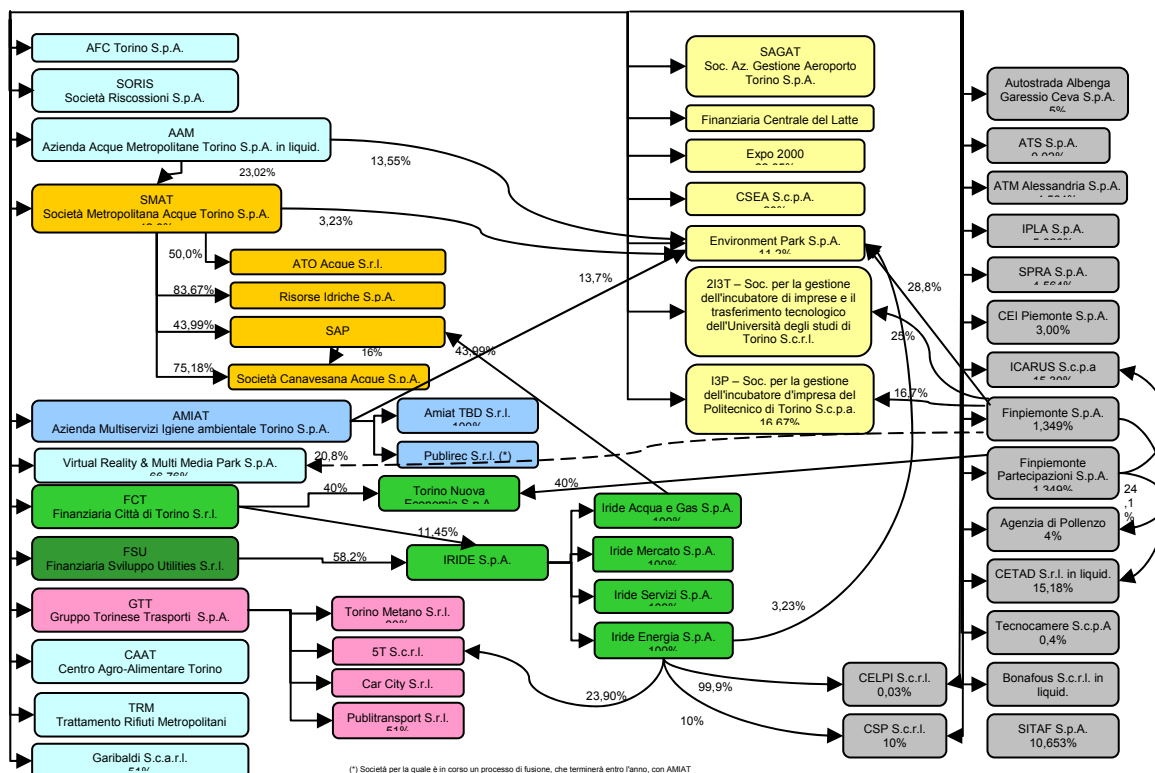


Figure 4. The sample. Source: [Developed by the authors]

The study of the abovementioned documentation has made it possible, partly through a deep analysis of the scientific contributions present on the subject, to develop a questionnaire/interview to submit to the parties who act as contacts on the board of directors of the groups sampled normally identified in the Internal Audit function. The questionnaire aims at identifying and highlighting the governance-related decisions adopted by the subsidiaries of Comune of Turin, with particular attention to the organisational model provided for in legislative decree 231/01 and the influences the same may have on the regulation of subsidiaries of Comune of Turin, with regard to administrative accountability and interest of public stakeholders.

The questionnaire is organised into three sections:

- a. general information about the company;
- b. corporate governance model;
- c. model of organisation, management and control pursuant to legislative decree n. 231/2001.

In particular the third section is structured into seven questions most of them closed:

Do you adopt the organisational model pursuant to legislative decree 231/2001?

If not, you will?

Are the group's information systems uniform?

Is the same access to the group's information technology available to all and any of subsidiaries of Comune of Turin?

Who is the party who regulates the operating procedures and the mechanisms of the group?

There is a responsible of the public infragroup control procedures?

Have you highlighted limitations and gaps in the organisational model pursuant to legislative decree 231/2001?

Has it been possible to highlight influences on the economic and financial situation of the individual company or the group following the implementation of the organisational model pursuant to legislative decree 231/2001?

If so, in what way?

100% of the sample answered the questionnaire making it possible for a sufficiently well organised analysis to be carried out. From the questionnaire, it emerged that 88% of the companies belonging to the single groups examined adopt the organisational model 231/01

To the question regarding the possibility of regulating infragroup relations through the organisational model pursuant to legislative decree 231/2001 the answers were all the same except in one case. It, in fact, emerged how there are no clear and explicit references to infragroup relations in the models adopted; in most of the cases, only the indication is given of the guidelines, very incomplete about the role the supervisory body should play with regard to the monitoring of a number of processes called sensitive and that involve more than one company in the group.

This gap was also indicated as a response to question eight that aimed at showing up the limitations encountered in the adoption of the said model.

Furthermore, the quality information emerging from the questionnaires relative to the institutional-, management- and governance-related aspects was later integrated with the quality information emerging from the analysis of the economical and financial documents of the reference group.

The reference sample, in 88% of cases, said it had homogenous information technology systems and certainly highlights the advantages, in economic and financial terms, in the adoption of the organisational model even if it is difficult to see.

## 5. Discussion

The public sector is a typical example of a principal – representative relationship. Public entity managers – who carry out their duties as representatives of the principal – must periodically account for the manner in which they have used and managed resources to the principal, as well as to what extent the public's objectives have been achieved. An effective auditing function reduces the risks inherent in this kind of



relationship. The principal relies on auditors for an independent and objective evaluation of the correctness of an agent's accounts, as well as information regarding the agent's use of resources in compliance with the wishes of the principal.

The necessity to have a third party attest to the credibility of financial reporting, profit or loss, and conformity and other criteria, is the result of many factors regarding the relationship between a principal and his agent:

1. Moral risks - conflict of interest: an agent may use resources and his authority to privilege his own interests, rather than those of the principal.
2. Distance: activities may be physically diverted from the direct supervision of a principal.
3. Complexity: a principal may not have all the necessary technical competences to control activities.
4. Consequences of errors: errors may be costly when agents manage large amounts of resources and are in charge of policies that affect citizens.

Since the success of a public administration is mainly measured by its ability to successfully provide services and carry out policies in a fair and appropriate manner, state audit functions must have the authority and competences necessary to evaluate whether public entities are carrying out their activities as planned, and if they are using their financial resources for the planned purposes in conformance with the requirements of laws and regulations. Audit activities based on verification answer the following questions: "Were policies implemented in the same way as planned?" and "Are the managers implementing effective controls to minimise risks?"

Control activities must also be extended to companies with shares in public entities; their influence on public entities is almost always exercised with a more or less important presence on the Board of Directors.

Auditing supports the structure of governance by verifying the results of agencies and policies, in financial and operating terms, and also by examining compliance with regulations and the purpose of the organisation in question. Auditing activities also support accountability, ensuring access to information on results within and outside of organisations.

In fact, public managers are responsible for determining direction and defining objectives, evaluating risks and implementing effective controls in order to achieve objectives and prevent risks. In their role as controllers, public administration auditors evaluate and report on the results of these efforts.

The adoption of the organisational models pursuant to legislative decree 231/01 has the function of exempting the body that provides for its adoption from accountability in the commission of offences of fraud, bribery or corruption committed by its directors/employees.

And what if the company, part of a group of companies is responsible for an offence such as to involve the whole group? What are the protections of the group before the offences committed by the individual companies? Is the model pursuant to law 231/01 adopted by the single subsidiaries enough to protect the group?

There are offences for which the error of the individual involves the group. As an example it is sufficient to consider the offence of false declarations in the financial statements: if this is committed by a company in the group it follows that the



reflections on the consolidated financial statements of the group are devastating. Who answers for it? In what way should the group be protected and the real culprits shown up? It is a complex mechanism of protection that must be identified in the interests of all the group's stakeholders.

The process of risk management and risk assessment must be based therefore on:

- identifying the risks of the group in relation to the offences of the subsidiaries that might be committed;
- in designing a preventative system of checking by the parent company, implemented through the construction of an adequate organisation system and the setting up of procedures for certain activities;
- in the adoption of a group code of ethics and a system of disciplinary sanctions that can be applied in the case that the measures provided for by the model are not complied with for the purpose of maintaining its effectiveness;
- in the identification of the criteria for choosing an internal control organisation equipped with the necessary functions that shall supervise the efficiency, the adequacy and the application of compliance with the model.

For the purposes of creating a risk management system, the aim is to divide the activities that pose a risk of offence for the group up into a series of procedures in order to prevent it being committed.

To activate a risk management system the company must therefore:

- map the company areas at risk
- determine the potential methods by which offenders can operate, in the areas specified above
- describe the system of controls activated and the adaptations for enhanced operation necessary.

In particular, it should be monitored the elements showing the involvement of the group can be broken down as follows:

- the systematic nature with which the people at the top of the company have had recourse to the instrument of corruption to win public contracts;
- the capacity of companies to create large availability of slush funds indispensable for being able to pay bribes to public functionaries able to influence the awarding of contract;
- the illegal management of the accounts of group companies with frequent and unjustified movement of capital between the various companies;
- the full agreement with the use of corruption by the reference shareholder;
- the serious, concrete and current danger of commissioning illicit acts of the same type as those for which proceedings are instituted.

The determination of the activities in the context of which offences might be committed presupposes an in-depth analysis of the company situation with the aim of establishing the areas that are involved in the potential cases of offence.

It is just as necessary to have an analysis of the possible ways of carrying out the said offences. This analysis must lead to an exhaustive representation of how offences can be committed with regard to the internal and external operating environment in which the company operates. In this analysis it will be necessary to take into account the history of the company – that is to say its past vicissitudes, even of a legal nature – and of the characteristics of the entities working in the same sector.

The analysis of the company's history and the corporate reality is essential for being able to determine offences that are easier to commit in the context of the company and the way they are committed. This analysis makes it possible to establish – on the basis of historical data – at which moment in the life and operations of the company risk factors are more likely to arise; what therefore are the moments in the life of the company that must more specifically be parcelled up and subject to procedures in order to be adequately and efficiently checked: for example the moment of the presentation of bids for the companies who take part in public appeals; the contacts with the competition; the methods of carrying out the contracts; the analysis of the attributes of external consultants (particularly concerning their cost and effectiveness), the management of economic resources, the movements of money inside the group etc.

The guidelines developed by a number of associations representing companies suggest the separation of tasks between those who carry out crucial phases in the context of a process at risk, the attribution of authorising signatory powers and powers of signature coherent with the organisational and management responsibilities, the existence of a monitoring system that can indicate critical situations. It is also suggested in the specific sector of relations with the public administration, that a manager be appointed inside the company for each individual operation that falls into areas of risk, with the obligation to produce specific documentation for the activities carried out; the adoption of further internal control thresholds when being a member of a consortium or a temporary association of companies, the adoption of instruments aimed at checking the existence, not merely accounting, of the services carried out by consultants, the adoption of instruments and mechanisms that make the management of the financial resources transparent and that, in synthesis, prevent the creation – through the issue of invoices for non-existent operations, through unjustified movements of money between companies belonging to the same group, through payments for consultancy never actually supplied or if supplied, supplied at a value far below that declared by the company – hidden availability of cash. It is in fact evident that the committing of a wide variety of those offences that the compliance programs should try to impede presupposes the company's availability money that does not emerge from the official accounting and that therefore can be spent without any form of control.

The need for a group organisational model that clearly regulates the infragroup relations is clearly greater the faster the rate at which the risk is growing of offences being committed. But how must the risk be determined? Are there elements that can determine the level of criminal-administrative risk to which a group is subject?

## 6. Conclusion

The research highlights the need to adopt specific techniques and instruments that are suitable for identifying and analysing all risks that could concern the group of local public companies.

It emerges in fact that Italian local public companies invest in systems to monitor performance and compliance, trying an integrated approach at group level. The objective is in fact the transversal and exhaustive nature of risk evaluation that leads to models of group organisation that are efficient and effective. Efficient, in such a way that the costs of managing the system are less than the benefits obtained in terms of risk coverage; effective in as much the organisational models integrated at group level increase the protection of the administrative and criminal accountability of the entire company group.

An unitary organisational model thus involves an integrated internal auditing system that must be well established inside the group of companies.

Furthermore, it becomes necessary for the public local group will have to entrust itself to an autonomous body of the company, imbued with its own powers of initiative and checking, the task of supervising the functioning and observing of the model and ensure it is updated.

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