CORPORATE GOVERNANCE REPORTING AND ITS SIGNIFICANCE IN MALTESE LISTED COMPANIES

09BACC030

By

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A Dissertation in
The Faculty of Economics, Management and Accountancy

Submitted in Partial Fulfilment of the Requirements for the Degree of Bachelor of Accountancy (Honours) at the UNIVERSTIY OF MALTA

April 2009
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To Roderick and my family

For all their love and support
Acknowledgements

I would like to sincerely thank all those who assisted me during the build-up of this dissertation. In particular, I would like to thank my tutor, Ms. Monique Micallef B.Com., BA(Hons.)(Accty.), M.Sc.(R'dg.), CPA, MIA for her invaluable help and advice throughout my work on this dissertation. My gratitude also goes to the other lecturers whom I consulted during the preliminary phases of this study.

I would also like to thank all those who participated in my interviews or replied to my questionnaires. Without their contribution this dissertation would not have been possible.

Finally, I give my special thanks to my boyfriend, Roderick, and to all my family, for their valuable advice, support and love throughout.
Declaration of Authenticity

I, the undersigned, declare that the dissertation entitled:

“Corporate Governance Reporting and its Significance in Maltese Listed Companies”

is authentic, insofar as it is the result of my own study and research and any conclusions or statements contained therein are mine, unless otherwise stated.

Marvic Cauchi

May 2009
Abstract

In the corporate governance statement, which is disclosed in the annual report, directors explain the extent to which they have adopted the principles of good corporate governance and the measures taken to ensure compliance with these principles throughout the accounting period. The statement enables users of financial statements to assess whether an organisation’s governance structure is satisfactory. This study sets out to assess the significance of corporate governance reporting in Maltese Listed Companies, mainly through the use of semi-structured interviews and questionnaires with representatives of Maltese Listed Companies and investors.

In Malta, the corporate governance statement is the principal medium through which companies communicate corporate governance information to their stakeholders; it is the only source used by all respondent companies for this purpose and by investors in order to obtain information on corporate governance. Most listed companies tend to examine the statements published by other listed companies in order to assess what disclosures are required by the market. While all companies believe that the corporate governance statement is value adding, this study concludes that there is a need for companies to acquire a better understanding of the information needs of users with regards to the corporate governance statement. It is evident that there is a mismatch between what companies believe that users’ information needs are and those needs that investors claim are actually being satisfied.

This study analyses whether listed companies and investors believe that certain changes should take place in order to enhance the method of reporting corporate governance matters. It concludes that, in general, neither group desires major changes from current practice.

Keywords: Corporate Governance Statement, reporting, Maltese Listed Companies, investors, annual report, ‘comply-or-explain principle’, Board and Committees
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List of Abbreviations

AIM: Alternative Investment Market
CGS: Corporate Governance Statement or Statement of Compliance with the Code of Principles of Good Corporate Governance
Code: Code of Principles of Good Corporate Governance
EU: European Union
IASB: International Accounting Standards Board
LSE: London Stock Exchange
MFSA: Malta Financial Services Authority
MLC / MLCs: Maltese Listed Company / Maltese Listed Companies
MSE: Malta Stock Exchange
OECD: Organisation for Economic Co-operation and Development
SEC: Securities and Exchange Commission
Chapter 1

Introduction
Chapter 1  Introduction

Directors need to provide stakeholders with information on corporate governance so as to assure them that the company is being managed properly. This dissertation sets out to examine the sources of information through which stakeholders are informed of the company’s corporate governance practices and focuses on the corporate governance statement since this is the main source of information used both by listed companies and by investors. It also examines how useful the corporate governance statement is perceived to be by MLCs and the role it plays in providing investors with useful information for decision making.

The first chapter starts off by defining corporate governance and discusses the requirements on listed companies to disclose information on their governance practices. It explains the need for this study, its objectives and limitations, and gives an overview of the subsequent chapters.

1.1 Background information

The Cadbury Committee (1992, p.15) defines corporate governance as follows:

*Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.*
The principles of the Organisation for Economic Co-operation and Development (OECD) define corporate governance in a similar manner. These principles are used by various countries as a basis for their national corporate governance requirements (Mallin, 2004). Although Malta is not a member of the OECD, the Maltese “Code of Principles of Good Corporate Governance” (the Code), is based on the OECD principles (MFSA, 2001).

Other authors define corporate governance differently (Mallin, 2004). These differences result mainly from different theories regarding who are the constituents for whose benefit the company should be managed; some theories state that the directors should act in the best interest of shareholders while others state that they should act in the best interest of all the stakeholders. The main theories which led to the concept of corporate governance are the agency theory, the stakeholder theory and the transaction cost economics theory. These will be explained in more detail in the next chapter.

The Malta Financial Services Authority (MFSA) provides the listing rules which companies listed on the Malta Stock Exchange (MSE) need to abide to, including rules which the directors are required to implement in order to ensure good corporate governance. Listing rules 8.36 to 8.39 require directors to present a Statement of Compliance with the Code of Principles of Good Corporate Governance (CGS). Directors must state their level of compliance with the Code. Users of financial statements are thus made aware of the company’s extent of compliance with the principles of good corporate governance and the measures taken to ensure compliance.
1.2 Need for such a study

Corporate governance has received a lot of attention recently, mainly due to recent high profile corporate scandals both in the US and in Europe, which have led to a decrease in investor confidence. Investors and stakeholders are becoming more concerned about how a company is managed. Since the CGS is the instrument through which the directors communicate matters related to governance, it is very important that the information disclosed in the CGS satisfies the users’ requirements, and that resources, in the form of time and money, used in its compilation, are perceived to be value adding.

Corporate governance reporting has not been given much attention in local studies. Thus there is the need for an in depth study focusing on the related disclosures, particularly the corporate governance statement which must be published as part of the annual report by companies listed on the MSE.

1.3 Objectives of the study

This study has the following objectives:

1. Evaluate the perception Maltese listed companies (MLCs) have of the current set of regulations governing reporting on corporate governance and certain potential changes thereto.

2. Analyse MLCs’ perceptions of the usefulness of disclosing the CGS and the role it has in providing investors with information on corporate governance and how useful such information is for decision making.
3. Assess whether and to what extent MLCs consider users’ needs when preparing the CGS.

4. Analyse whether the CGS is published with the aim of providing useful information to users of financial statements or simply for the sake of compliance.

5. Analyse the point of view of listed companies and users of financial statements regarding the current presentation of the CGS.

6. Assess whether MLCs and investors believe that certain changes should take place in order to improve corporate governance reporting.

1.4 Limitations

Although financial reporting is sometimes included as part of corporate governance, this thesis focuses only on reporting regarding actions and procedures in place to ensure good corporate governance.

In addition, companies can report corporate governance information through various means such as the annual and interim reports, preliminary announcements, official statements, web sites and prospectuses. However this thesis focuses mainly on reporting to shareholders through the annual report by means of the CGS.

The International Accounting Standards Board (IASB) framework defines users of financial statements as present and potential investors, lenders, employees, suppliers and other trade creditors, customers, governments and their agencies and the public. However it goes on to state that

*While all of the information needs of these users cannot be met by financial statements, there are needs which are common to all users. As investors are providers of risk capital to the enterprise, the provision of financial statements*
that meet their needs will also meet most of the needs of other users that financial statements can satisfy (IASB framework, 1989, p. 45).

Due to time and word length constraints research on the views of users regarding the CGS has been limited only to the investors user-group.

1.5 Overview

This chapter has provided a brief description of what corporate governance entails and has introduced the requirement on MLCs to report on corporate governance. Chapter two discusses the literature on corporate governance and the codes of corporate governance of various countries including Malta, as well as the level of compliance with such codes. Chapter three explains the ways in which primary and secondary data were collected for this study. The results obtained from the empirical research are presented and discussed in chapter four. The final chapter presents a summary of the study, the conclusions drawn by the author and suggestions for further research. This dissertation outline is illustrated in figure 1.1.
Figure 1.1: Dissertation Outline

- Chapter 1: Introduction
- Chapter 2: Literature Review
- Chapter 3: Research Methodology
- Chapter 4: Research Findings and Discussion of Findings
- Chapter 5: Summary, Conclusion and Recommendations
Chapter 2

Literature Review
Chapter 2 Literature Review

This chapter starts by giving an overview of what corporate governance entails. Subsequently, it gives a brief overview of the regulatory framework in Malta and in a number of other countries. Finally, it discusses studies that have been made in other countries on the level of corporate governance reporting.

2.1 Corporate governance

The management of a listed company is essentially separated from its ownership. This leads to the principal-agent relationship (Meckling and Jensen, 1976) which views the firm as a series of contracts, with the most important contract being between the shareholders and the directors of the company. The directors are entrusted by the shareholders, the ultimate owners, to manage the latter’s best interest. However, a principal-agent conflict could arise where the directors act in their own interest rather than that of the shareholders. There are alternative views of corporate governance. The transaction cost economics theory, views the firm as a governance structure rather than a series of contracts (Williamson 1975; Williamson 1984). The stakeholder theory, on the other hand, takes into account a wider group of constituents. It states that the directors should act in the best interest of all stakeholders, not only of the shareholders (Mallin, 2004). All these theories have affected the development of corporate governance (Fig 2.1).
Figure 2.1: Main theories influencing the development of corporate governance

2.1.1 Defining corporate governance

Various definitions have been given of what constitutes corporate governance. It has been described by the Cadbury Committee (1992, p.15) as “the system by which business corporations are directed and controlled”. The definition given by Sheridan and Kendall (1992) states that good corporate governance consists of a system of structuring, operating and controlling a company so as to:
• Fulfill the long-term strategic goals of the owners, which may include increasing shareholder value or establishing a dominant market share
• Consider and care for the interests of employees, throughout the organization’s life cycle.
• Take account of the needs of the environment and the local community and the company’s impact thereon.
• Work to maintain excellent relations with customers and suppliers
• Maintain proper compliance with all the applicable legal and regulatory requirements.

Phillips and Thomas (n. d. [online]) argue that “good corporate governance can be achieved only if it is an embedded part of corporate life”.

2.1.2 The role of directors

Chapter VIII of the Maltese Companies Act (1995) deals with the management and administration of companies. Article 136A lays down the duties of directors (Appendix C). It states that directors are responsible for the general governance of a company, its proper administration and management, and the general supervision of its affairs. The law requires directors to act in the best interest of the company, and since the shareholders are the owners of a company, they are required to act in the best interest of the shareholders, and only in the interest of other stakeholders if they are the same as those of the shareholders. If permitted by the Articles of Association of the company, the directors may delegate their functions either to board committees or to management. The strength of a company depends on the ability of its management group to work together and attain successful results (Tricker, 1984).
A survey by PricewaterhouseCoopers on United States multinational companies (2003 cited Collins, 2003 [online]) found that in their efforts to ensure sustainability, senior executives do not focus only on long term profitability. Table 2.1 below shows the top five factors considered according to this survey:

<table>
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<th>Factor</th>
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<td>Positioning for long-term profitability</td>
<td>91%</td>
</tr>
<tr>
<td>Governance and corporate ethics</td>
<td>71%</td>
</tr>
<tr>
<td>Investors</td>
<td>65%</td>
</tr>
<tr>
<td>Employee work conditions, retention, development, and benefits</td>
<td>54%</td>
</tr>
<tr>
<td>Management oversight and compensation</td>
<td>54%</td>
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Cassar (2006) found that MLCs are becoming increasingly aware of the concept of corporate governance, especially in companies where there is a solid executive structure and where board committees are present.

In three separate surveys\(^1\) conducted by Coombes and Watson (2000 [online]), published in the McKinsey quarterly, it was found that for three-quarters of the investors interviewed, improved corporate governance practices at the board level are at least as important as financial performance when evaluating companies for investment.

\(^1\) The first survey was conducted in Asia in September and October 1999, the second survey was conducted in Europe and the United States in October and November 1999 and the third survey was conducted in Latin America during March and April 2000.
2.2 Corporate governance codes and the corporate governance statement

The introduction of corporate governance codes in various countries during recent years has taken place with the intention of increasing transparency and accountability (Mallin, 2004) and usually followed a financial scandal, corporate collapse, or similar crisis. Such codes should lead to an increase in investor confidence in the capital market.

2.2.1 Influential codes

In order to overcome the principal-agent conflict mentioned earlier, it is important that management and directors of a company report to shareholders on what activities are taking place to manage the company in the best way possible.

The OECD model (2004) presents a set of characteristics that are fundamental to good corporate governance. It does not seek to come up with a model which is applicable to all countries as it recognizes that ‘one size does not fit all’ (OECD, 1999 cited Mallin, 2004, p.28). These principles are grouped under the following headings: the rights of shareholders; the equitable treatment of shareholders; the role of stakeholders in corporate governance; disclosure and transparency; and the responsibility of the board. The World Bank’s corporate governance assessments of counties are based on these principles. The Report of the Cadbury Committee (1992), which, in 1998, was combined with the Hempel Report to form the new Combined Code for the UK, has also been influential in the
enactment of corporate governance codes in other countries. Several international bodies\textsuperscript{2} have had an influence on the corporate governance codes of other countries (Mallin, 2004).

There is a debate regarding whether corporate governance rules should take a more principles based approach. According to Groom (2002 [online]), an emphasis on principles rather than the enforcement of prescriptive rules promotes compliance with the substance rather than the form of the requirements.

\subsection*{2.2.2 The Maltese Code of corporate governance and the corporate governance statement}

Prior to 2002, the MSE was the regulator of MLCs. The listing rules were first enacted in 2001 as part of the Bye-Laws for adoption by listed companies, except for Listed Collective Investment Schemes (MSE Working Group, 2001). Since 2002 the MFSA has acted as the regulator of MLCs (Fabri, 2005). Listing Rules 8.36 to 8.39 regulate the inclusion of a CGS in the annual report of MLCs in which the directors are required to explain what measures they have taken to ensure compliance with the Code of Good Corporate Governance and the extent to which they have adopted the principles of the Code. These principles are found in Appendix 8.1 of the MFSA listing rules and are based on the guidelines provided by the OECD (MFSA, 2001). MLCs are not required to comply with these principles, as long as the extent of non compliance is disclosed in the CGS. This is known as the ‘comply or explain principle’.

However, MLCs are advised to comply with these principles as they provide standards of corporate conduct in matters such as the roles and responsibilities of the board, the

\footnotesize{\textsuperscript{2} These include the Global Corporate Governance Forum, the International Corporate Governance Network and the Commonwealth Association for Corporate Governance.}
directors and officials of the company and institutional investors; relations with shareholders and the market; conflicts of interest; executive remuneration; conduct of board meetings; professional development and corporate social responsibility (Macdonald, 2006). In 2006, the MFSA commented that (cited by Macdonald in The Business Weekly, 27 July 2006, p.6):

The Principles are designed to enhance the legal, institutional and regulatory framework for good governance in the Maltese corporate sector by providing a set of standards that promotes more transparent governance structures and practices thereby enhancing market integrity and confidence and ensuring a higher degree of accountability to shareholders.

In 2005, the MFSA issued a proposal for including a number of obligatory clauses, such as having a separate chairman and CEO, non-executive directors on the board, a remuneration committee and an annual review of the board’s performance, as a result of the EU Commission recommendation of 15 February 2005 (MFSA, 2005). This proposal was received with mixed views. In 2006 the Audit Committee, which must be chaired by a non-executive director became mandatory, while the other provisions were left as guidelines (Macdonald, 2006).

According to Sant (2003) the introduction of the Code in 2001 brought greater awareness on company governance and control, as companies had to consider whether their governance systems at the time fulfilled the requirements of good corporate governance. However the Code, being practically a reproduction of the Cadbury Code and the OECD model, was not adapted to the Maltese scenario and this led to it being only partially implemented. Also, companies said that the Code is not user friendly and claimed that they had difficulty understanding certain critical issues. Adoption of these principles could have been facilitated had the MSE issued an explanation of some of the corporate governance terms and a set of recommendations.
Sant (2003) observed that since companies have different structures and operate in various sectors, the same Code cannot be made mandatory for all listed companies, but still suggests that there should be legislation and penalties to deter companies from adopting undesirable attitudes.

The Listing Rules also require the independent external auditor to issue a report on the statement of compliance, separately from the opinion on the financial statements. Here, the auditor makes a statement in which he mentions the responsibilities of the directors, and their responsibilities regarding the CGS, together with an opinion as to whether the CGS was properly prepared in accordance with the requirements of the Listing Rules.

A typical CGS includes the following sections:

- Compliance with the Code of Principles of Good Corporate Governance – here a company discloses the extent of its compliance with the Code
- Roles and responsibilities of the Board of Directors – includes a list of the directors who held office during the year, the number of meetings held by the board, and the responsibilities of directors
- Going Concern evaluation – it is stated whether the company is likely to continue operating as a going concern
- Committees – including Board Committees and Management Committees
- Internal Control – a list of procedures in place to ensure internal control, such as risk identification and reporting procedures and a description of the control environment
- Relations with shareholders and with the market – including timely publication of information that may be price-sensitive and communication with the shareholders during the Annual General Meeting
In a survey conducted in Malta by Vassallo (2005) it was found that on average MLCs disagree that the CGS should be harmonized as to form and content with that of other EU countries, because of the different structures of companies across EU Member States, and since they apply different codes of corporate governance.

Vassallo (2005) also observed that in the past few years individual investors have increasingly sought professional financial advice when making investment decisions. Therefore, financial advisors and stockbrokers can pass on the information contained in the annual report, including the CGS, to investors even though they might not otherwise read or understand it.

2.2.3 Comparisons with the corporate governance codes of other countries

UK

The Combined Code on Corporate Governance (2008) sets out the standards of good practice regarding issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. The Combined Code requires companies incorporated in the UK and listed on the Main Market of the London Stock Exchange (LSE) to report on how they have applied the code’s provisions in their annual report and accounts, in accordance with the Listing Rules.

Other European countries

Although in Continental Europe there are different ownership structures and legal systems, countries are moving towards convergence on the basic characteristics of good corporate governance (Mallin, 2004).
In a study conducted by the European Commission in 2002 (International Finance Corporation, 2008 [online]), it was concluded that the European Union (EU) should not attempt to develop one corporate governance code for all member states, but rather should encourage convergence of countries’ corporate governance codes. The EU Directive (2006) ‘Amendments to 4th and 7th Company Law Directives 2006/46/EC’ requires listed companies to include a CGS in the annual report in which the company explains the extent to which it has complied with the applicable code. In a report published in 2007, it was found that all Member States had issued corporate governance codes, with most of them making use of the comply-or-explain principle (International Finance Corporation, 2008 [online]).

USA

The USA does not have a definitive corporate governance code, but there have been a number of state and federal developments over the years. The majority of US companies listed on the New York Stock Exchange are registered in Delaware so as to take advantage of the more flexible, non-prescriptive approach in force in this state, which allows them to aim for the corporate goals and strategies while acting in the best interest of the shareholders. (Mallin, 2004)

Australia

The Australian Stock Exchange also requires companies to disclose in their annual report the extent of compliance with the principles on corporate governance. A review issued by the Australian Stock Exchange (2006 [online]) shows that listed companies are continuing to improve their corporate governance reporting, as in 2005 the extent of compliance with the Listing Rules and the provision of an explanation in the case of non compliance were higher than in 2004.
2.2.4 Level of compliance with corporate governance codes

In a survey of 85 companies registered on the LSE\(^3\) (Independent Audit, 2004 cited Evans, 2004 [online]), it was found that most FTSE100 companies are only observing the principles of the Combined Code for the sake of compliance, rather than with the intention of providing information to shareholders regarding the effectiveness of the board of directors. For example, although companies are required by the Code to describe how the board operates, this survey showed that about half of the companies interpreted this as a requirement to disclose the board’s roles and responsibilities. Additionally, although 66% of companies tested the effectiveness of the board, only 18% used external advisors for this purpose. Most used some form of self assessment, and a few did not disclose the method used.

Independent Audit (2004 cited Evans, 2004 [online]) argues that with the large number of firms using self-assessment and with not much information provided about the outcome, firms “risked sounding complacent or uncommunicative, or both”. However, there were firms whose reporting on corporate governance was very meaningful, such as Cable & Wireless, Marks & Spencer and Tomkins, which also described what follow-up action took place as a result of board evaluations. It is interesting to note that these three companies have all had highly publicized governance issues in the recent years. However, Evans (2004 [online]) observed that “in the long run it will be important that good quality corporate governance reporting is seen as a sign of current strength not past weakness”.

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\(^3\) This survey was carried out in the UK by Independent Audit in 2004 on 85 companies registered on the LSE that had published their reports between 1 November 2003 and the end of August 2004.
The survey concluded that it is difficult to report on board effectiveness due to the variable quality of reporting observed, which the author described as demanding “the skill of a storyteller rather than of an accountant” (Evans, 2004 [online]).

Another survey was conducted by Pass (2006 [online]) on 50 large UK companies with their financial year ending in 2005. It was found that 30 of these companies fully complied with all of the governance provisions listed in the Combined Code and the Listing Rules of the London Stock Exchange, or provided an explanation as to why they did not comply with these principles.

PricewaterhouseCoopers (2008 cited Stafford, 2008 [online]), found that only 3% of the Alternative Investment Market (AIM)\(^4\)’s top 100 companies, ranked by market capitalisation, choose to comply fully with the Combined Code, while 77% comply only with some aspects of it. PricewaterhouseCoopers commented that 28 companies had their shares suspended in July 2008 for failing to file their December accounts before the June deadline. This raised doubts about the suitability of the voluntary approach to corporate governance currently adopted by the LSE and could lead to rules being tightened, or even being made compulsory. However, the LSE says it has no plans to compel companies to sign up to a code as it would like to retain its reputation as a “light-touch market for fledgling companies” (LSE cited Stafford, 2008 [online]). PricewaterhouseCoopers also discovered that the majority of AIM companies publish a separate CGS. However the AIM does not have any prescribed corporate governance requirements, therefore it tends to look at the main market for guidance.

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\(^4\) “AIM is the London Stock Exchange’s international market for smaller growing companies,” (London Stock Exchange, n.d. [online]).
2.3 Corporate governance reporting

Directors are required to regularly inform the shareholders about what actions have been taken in order to manage the company effectively (Tricker, 1984). This section will discuss the perception of corporate governance reporting, the level of corporate governance information disclosed by companies in various countries and changes that have been proposed in order to improve corporate governance reporting.

2.3.1 Perceptions of corporate governance reporting

According to Phillips and Thomas (n. d. [online]) the benefits that a company can obtain through proper internal governance structures and improved external transparency in these areas are “better decision making, lower stock price volatility and cost of capital, and better stakeholder engagement”. Companies’ apparent unwillingness to disclose corporate governance information indicates that many businesses are not yet aware of these potential benefits. This was discovered through a study conducted by Newell and Wilson (2002 [online]) among institutional investors in 31 countries, which found that on average they will pay a premium for shares of companies which have transparent systems of corporate governance. For example, for Polish companies, institutional investors would be willing to pay a 20% premium for the shares of a company with sound, transparent corporate governance systems.

This contrasts with the findings of a study conducted by Stainbank and Peebles (2006 [online]) in South Africa, where users and preparers of financial statements were asked to indicate how thoroughly they read each component of the annual report. It was found that the CGS (and other reports such as the environmental report and the employee report) was
not given a high ranking, despite initiatives such as The King Report on Corporate Governance for South Africa and the Global Reporting Initiative. A possible explanation for the low ranking may be that investors use financial information with the aim of making a profit from the increase in the market price of shares and thus quantitative information may be given more importance than qualitative information.

In a survey conducted in Malta (Briffa, 2005) it was found that when compared to the other statements in the annual report, the CGS was ranked 9th in terms of readership, perceived importance, perceived level of understanding, relevance and reliability. In all these characteristics, the profit and loss account, balance sheet, cash flow statement, statement of changes in equity, notes to the accounts, director’s report, chairman’s report and the auditor’s report were ranked prior to the CGS, while the review of operations, financial review, five year summary and shareholder register information were ranked last. The statements were ranked in this order for all the factors mentioned.

2.3.2 Level of corporate governance disclosure by listed companies

The International Journal of Accounting, Auditing and Performance Evaluation (n.d. [online]) observed that disclosure requirements related to corporate governance are placing a significant burden on firms with limited, if any, benefit resulting. It also expressed concern about the possible cluttering that may arise in the financial reporting process as a result of the increase in the reporting of corporate governance details, which could hinder transparency. This leads to doubts as to how corporate governance reforms and the resulting impact on financial reporting will help to address the concerns with the current volatility of international capital markets.
Past experience shows that in Central European countries, companies begin to report on their compliance with a corporate governance code only when it becomes mandatory (Šulenta, et al, 2005 [online]).

Recently there has been a debate regarding the disclosure of executives’ and directors’ remuneration. In the UK, listed companies must disclose the name of the consultant that was engaged to give advice regarding executive pay. Also, if the remuneration packages were based on those of similar companies, such companies must be disclosed. In 2006, the Securities and Exchange Commission (SEC) issued a proposal which would increase transparency in this area through an increase in the level of disclosure of pay, value of stock options and all other compensation and perquisites of the CEO, CFO, the next three most highly paid executives and the directors. However the SEC proposal does not include the two UK requirements mentioned above and thus US disclosures are not expected to reach UK standards. (Balachandran, 2006)

2.3.3 Potential changes in requirements

Baldacchino (2007) suggests that rather than increasing the level of disclosure required in the CGS, it would be better to focus on ensuring that only competent persons are given responsibility to act as directors of MLCs perhaps by tightening the minimum qualifications required for a person to act as a director.

Another suggestion by Baldacchino (2007) is to divulge information on the company’s corporate governance only if something exceptional has occurred, such as a major change in controls or risks. This is similar to the approach used in auditing, where the auditor only gives information if there is the need for qualification or emphasis. This could aid the
financial reporting process as the annual report is already heavily regulated and it is becoming even more so. Also, an independent management specialist, who has more of the required skills in this area, could be required to compile the CGS rather than having a financial auditor issue an opinion on such a statement.

2.4 Conclusion

This chapter has given an overview of the theoretical, regulatory and empirical aspects of corporate governance. It has also described how different companies in different countries tackle their reporting responsibilities in this area. The next chapter discusses the methodology adopted in this study.
Chapter 3

Research Methodology
3.1 Introduction

This chapter outlines the methodology used to gather the data for the purposes of this study and explains the reasons behind the choices of the research methods used. Figure 3.1 overleaf illustrates the stages from the conception of the idea for this dissertation through the collection of data.
Chapter 3 – Research Methodology

Figure 3.1: Overview of research methodology

START

AREA OF DISSERTATION

PRELIMINARY DATA COLLECTION

FEASIBLE?

IDENTIFICATION OF RESEARCH OBJECTIVES

PLANNING

THEORETICAL DATA COLLECTION

EMPIRICAL DATA COLLECTION

ANALYSIS OF FINDINGS AND DISCUSSION

SUMMARY, CONCLUSION AND RECOMMENDATIONS

END

Chapters 1 & 3

Chapter 2

Chapter 4

Chapter 5
3.2 Primary Data

Primary data was collected through semi-structured interviews with representatives of MLCs and through questionnaires sent to the licensed members of the MSE. Data was also collected through an analysis of the annual reports of MLCs, especially the section on corporate governance, in order to get an idea of the corporate governance practices within respondent companies and whether they comply with the principles of good corporate governance.

In the case of MLCs, the population consists of fourteen companies listed on the main market of the Malta Stock Exchange as at 31 December 2007. This number thus excludes the three companies which became listed in 2008, since these companies had not published their first annual report after listing on the MSE by the time the research was conducted. Prospective interviewees were first contacted by telephone and were provided with a list of the questions that would be posed during the interview, together with a covering letter (Appendix E) from the dissertation tutor on behalf of the University of Malta. Interviews were carried out between November and December 2008 at the respondents’ premises and each lasted around an hour. Seven companies did not accept to be interviewed, leading to a participation rate of 50%.

Questionnaires were sent to the twelve licensed members of the MSE as at November 2008 so as to assess their point of view regarding corporate governance disclosures, with particular focus on the information disclosed by MLCs in the CGS. These were contacted by telephone and the questionnaire and covering letter were sent by e-mail. Six out of the twelve stockbrokers accepted to participate, resulting in a response rate of 50%.
3.3 Structure of the interviews and questionnaires

3.3.1 The Interviews

The interview schedule, which is reproduced in Appendix A, consists of four main sections. The first section related to regulations governing corporate governance reporting. The next section deals with the various sources of information from which users can obtain information on corporate governance, the compilation of the CGS in particular and perceptions of its relative usefulness held by listed companies. The third section includes questions related to the users of financial statements, such as which user group is perceived to benefit the most from the CGS and whether companies consider users’ needs when preparing the CGS. The last section deals with potential changes that could take place in order to improve corporate governance reporting.

Some of the questions asked during the interview were open ended and led to further discussion and probing questions being asked. Other questions required respondents to rank a number of factors or to express the degree to which they agreed with a statement based on a 5 point Likert scale. For the ranking, 1 denoted the most important factor, while for the Likert scale, 5 indicated that respondents strongly agreed with a statement or considered the factor to be very important, while 1 meant that they strongly disagreed or believed that the factor was not important.
3.3.2 The Questionnaires

The questionnaire sent to investors was a secondary area of the study (Appendix B). Where relevant, questions from the second, third and fourth sections of the interview schedule were also posed to investors. This made it possible to compare and contrast the replies from the two groups.

3.4 Secondary Data

Secondary data was collected by researching, examining and analyzing various sources of data related to this study. Both published and unpublished sources were consulted to collect the secondary data cited in this study. These included books, periodicals, research and working papers, reports, web sites and past dissertations. The codes of corporate governance of other countries were also analysed and discussed so as to get a general idea of the level of regulation related to corporate governance reporting which is present in other countries.

3.5 Analysis of findings

The replies to the quantitative questions were analyzed through statistical techniques using SPSS software, while the replies to the qualitative questions were compared to bring out any common features and highlight any differences.

The Likert scaling technique was used, where respondents were presented with a set of statements and were asked to express agreement or disagreement on a five-point scale. A
total and mean numerical value was calculated from all the responses, which shows the overall level of agreement with a particular statement.

A number of techniques were used to assess whether these results are significant and can be generalized. The Chi-Square test was used to check for association between two categorical variables; the One-Way ANOVA test was used to compare the mean rating scores between two independent groups, namely listed companies and investors; and the Friedman test is used to compare the mean ranking scores of several user groups. The P value is the criterion used in all these tests to determine whether to accept H0 or H1. If the P value exceeds the 0.05 level of significance, H0 is accepted. Otherwise H1 is accepted. H0 means that there is no association between the two while H1 means that there is a significant association. Spiegel et al. (2000)

These interviews and questionnaires gave an insight on the perception of MLCs and investors on the disclosure of a CGS together with their financial statements. The replies were a good basis on which to draw conclusions and gave light to further studies that can be undertaken in this area. Some suggestions for further research can be found in Chapter five.

3.6 Conclusion

This chapter has explained the research methodology adopted for this study. Primary data were collected through semi-structured interviews and questionnaires with representatives of MLCs and investors. Secondary data sources encompassed both published and unpublished works. The results of this study were analysed and interpreted and the findings and their discussion and recommendations are presented in the following chapters.
Chapter 4

Presentation and Discussion of Findings
Chapter 4   Presentation and Discussion of Findings

This chapter presents the results obtained from the interviews held with representatives of MLCs and from the questionnaires received from stockbrokers. It compares the responses of those two groups both with each other and with what was quoted in the surveys and papers in the literature review.

4.1 Regulations governing reporting on corporate governance

Table 4.1 shows the mean score of MLCs when asked on the extent to which they agree with statements relating to the Code.

<table>
<thead>
<tr>
<th>Table 4.1</th>
<th>Aspects of the Code of corporate governance</th>
<th>Mean</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a)</td>
<td>Disclosing all the required information in the corporate governance statement helps to convey a more positive image of the company</td>
<td>4.571</td>
<td>0.535</td>
</tr>
<tr>
<td>b)</td>
<td>MFSA listing rules assist companies in improving corporate governance transparency and accountability to shareholders</td>
<td>4.571</td>
<td>0.535</td>
</tr>
<tr>
<td>c)</td>
<td>Corporate governance principles rather than prescriptive rules make it easier for firms to comply with the substance of these principles</td>
<td>4.143</td>
<td>0.900</td>
</tr>
<tr>
<td>d)</td>
<td>Principles rather than prescriptive rules are better for improving transparency</td>
<td>3.857</td>
<td>0.900</td>
</tr>
</tbody>
</table>

Companies strongly believe that disclosing the required information in the CGS helps to convey a more positive image of themselves. One interviewee stated that such disclosures
help the company to be transparent in all those respects that can in some way or other influence stakeholders. Another company commented that such disclosures also improve the business image by showing that the company is abiding to good stewardship principles. It is believed that transparency and dialogue give comfort to stockbrokers, thus those companies which do not disclose the required information are affected adversely. A number of companies also stated that it is important not to disclose commercially sensitive information that can be used for the advantage of competitors.

In response to the first objective of this study, it was found that companies believe that the MFSA listing rules assist them in improving corporate governance transparency and accountability to shareholders. This is consistent with the claim made by MFSA (cited by Macdonald in The Business Weekly, 27 July 2006) as explained in Section 2.2.2.

On the other hand it was also pointed out that the listing rules may at times be unnecessarily long and too complex to understand. Only 28.57% of respondents believe that the Code is appropriate for the Maltese scenario. Reasons provided as to why it is not appropriate were that it is “a bit too taxing” or that “it is simply a replication of the codes of other countries and no tailoring was made to the Maltese scenario”, which is characterised by smaller, less complex businesses. This is consistent with the statement by Sant (2003) that the Code is practically a reproduction of the Cadbury Code and the OECD model.

In addition, only 42.86% of companies believe that the Code is user friendly, and one of them stated that professional assistance is required in understanding certain critical issues. The other 57.14% remarked that they had trouble understanding such issues, even with professional assistance. A recommendation could be to have a help desk at the MFSA, manned by experts of the Code, who can assist companies in interpreting the principles, even by referring them to similar past cases.
One of the companies argued that the provisions related to the CGS and the Code, burden listed companies with extra costs, making it difficult for them to compete with unlisted companies.

Most of the companies prefer having corporate governance principles rather than prescriptive rules (71.43% agreed, while 28.57% were neutral). Representatives of companies said this brings the advantage that when in doubt, one can check on the substance of the principles and try to understand them to the best of their knowledge. This should also lead to less heavy penalization for not abiding by the rules as principles are more flexible and can be interpreted according to the circumstances. This is consistent with the argument that an emphasis on principles rather than rules promotes compliance with the substance rather than the form of the requirements (Groom, 2002 [online]).

However, it was observed that companies agreed less strongly, with a mean of 3.857, that having a principles-based approach improves transparency. One of them stated that this depends on how these requirements are interpreted; principles may give companies the opportunity to avoid disclosing certain information.

4.1.1 Level of compliance with the Code

An examination of the annual reports of respondent companies for the financial years 2003-2008 showed that only 14.29% complied completely with the Code. The annual reports of the other respondents stated clearly that the board believes that they should differ from a particular principle, but none of them gave explanations of the underlying reasons. This contrasted with the study by Pass (2006) and is more comparable to the results of a study
conducted on the AIM of the LSE (PricewaterhouseCoopers, 2008 cited Stafford, 2008 [online]), which are explained in more detail in section 2.2.4.

The most common types of non-compliance involved companies not disclosing the remuneration of each director separately and companies not setting up a remuneration or evaluation committee. 28.57% of the companies stated that such committees are deemed unnecessary due to the small size of the business or because the directors are already under the close scrutiny of shareholders. It thus seems that not having a mandatory code suits listed companies well as they can choose which principles to adhere to.

4.2 Reporting on corporate governance

4.2.1 Sources of information on corporate governance

Companies were asked to rank the mechanisms they use to disseminate information about the entity’s corporate governance practices and standards, while investors were asked to rank what mechanisms they use to obtain such information. Figure 4.1 shows the results obtained.
All companies must provide corporate governance information in the annual report and it is the most widely used mechanism by stockbrokers to obtain such information. It is the only mechanism used by all companies and stockbrokers interviewed. The main reason behind this is that it gives more detailed information on corporate governance than the other means of communication. In addition, all companies also stated that they disclose corporate governance information through one or more other means of communication. MLCs stated that the level of disclosure in the other means of communication depends on legal requirements, on the amount of space the company has available and on the level of information that the company believes it should disseminate. These results differ from what was found in Croatia, where most companies provide more detailed corporate governance reports in their prospectuses than in their annual reports (Šulenta, et al, 2005 [online]).

In spite of the apparent differences between the two groups as shown in the cluster bar graph (Figure 4.1) there is no bias between listed companies and investors in the
importance they give to the different tools since the chi-square test yielded a P value of 0.876 which exceeds 0.05.

Stockbrokers also consider the meetings that companies hold with them to be very useful as these allow discussions and explanations to take place directly. Some of the listed companies even send magazines to shareholders and hold meetings with stockbrokers to inform them of any changes that have taken place within the company.

4.2.2 Compilation of the CGS

85.71% of the companies stated that the CGS is drawn up by the company secretary based on the information and guidelines given by the executive directors, especially the chairman and the managing director. The CFO, audit committee and compliance committee are also involved in some of the organizations.

57.14% of the companies stated that the compilation of the CGS is an ongoing process which takes place throughout the year, with attention to this statement being given in every board meeting. The final compilation of this statement takes from 2 days to 2 months.

Most of the companies (71.43%) examine the CGS of other listed companies in order to obtain an understanding of the market trend and thus what they are expected to disclose. This also serves as a way to benchmark with best practice. The other 28.57% of the companies do not feel the need to carry out such an exercise because the characteristics and circumstances of firms differ (Figure 4.2).
4.2.3 Perception of the usefulness of the corporate governance statement

The CGS is perceived as value adding by all the companies. This contrasts with the statement that corporate governance disclosure requirements are placing a significant burden on firms with limited, if any, benefit resulting (International Journal of Accounting, Auditing and Performance Evaluation, n.d. [online]). However 42.86% of the companies also recognise that its preparation adds to their costs and to the directors' level of responsibility.

28.57% of the companies stated that the CGS is value adding to shareholders rather than to the company as it gives them access to more information and assures them that the company is compliant with certain regulations. The same percentage of companies see it as value adding directly to the company, mainly because its compilation may lead to the identification of shortcomings within the company which can then be rectified.
It therefore emerges that in spite of the time and cost involved in its compilation, the CGS may be both directly and indirectly value adding to the company.

All companies and investors stated that the CGS is an instrument to improve financial accounting transparency, rather than an additional disclosure. This contrasts with the argument that the CGS increases the cluttering in financial reporting (International Journal of Accounting, Auditing and Performance Evaluation n.d. [online]).

4.2.4  Relative usefulness of the CGS

Companies and investors were asked to rank the statements found in the annual report according to the amount of useful information they provide, as shown in Figure 4.3.

![Figure 4.3 Statements in the annual report](image-url)
The CGS was ranked 3rd by companies, together with the chairman’s review and the income statement and 8th by investors. The latter result is consistent with the findings by Briffa (2005), where investors ranked the CGS 9th in terms of readership, perceived importance, perceived level of understanding, relevance and reliability, from the statements as mentioned in Section 2.3.1. These results contrast with the results of the surveys conducted by Coombes and Watson (2000 [online]) where three-quarters of the investors interviewed considered improved corporate governance practices at the board level to be at least as important as financial performance when evaluating companies for investment. The CGS was not given a high ranking in South Africa, despite initiatives promoting it, as discussed in Section 2.3.1 (Stainbank and Peebles, 2006 [online]).

One of the investment companies stated that they do not give much importance to the CGS as they look only for financial information when reading the annual report, thus focus their attention on the balance sheet, profit and loss account and cash flow statement. This may be problematic; investors could be able to make better informed decisions if they interpreted financial information in the context of the general circumstances of the company as illustrated by non-financial information. Investors also believe that the CGS is often a replication of the previous year’s report, with barely any changes. This might often be the case. An examination by the author of the CGS of respondent companies for the 2003-2008 period showed that companies tend to use a predefined format and wording and only make minor adjustments when there are changes in the corporate governance structure of the firm. However, users cannot be assured that no change has taken place unless they read the statement and check that the structure has remained the same.

From the results related to the second objective, it is evident that the CGS plays an important role in providing users with information on corporate governance, since the annual report is the only source used by all investors to obtain such information. Also all
companies believe that it is value adding to users and that it improves financial accounting transparency. However, as explained in Section 4.2.4, when compared to the other statements of the annual report, the CGS does not play an important part for users to obtain information useful for decision making. This implies that information on corporate governance is not given high importance for decision making as investors tend to focus on the operational results of the company.

4.2.5 Auditor’s opinion

All companies agreed, with a mean of 4.286 that the auditor’s opinion on the corporate governance statement affects investors’ level of confidence in it and their perception of its reliability. This shows that MLCs believe that the services of the auditor are beneficial to investors. However, only 50% of the investors agreed with this statement leading to a mean of 3.17. This might show that the auditor’s opinion is perceived to be more value adding by companies than by investors. However, although a clean auditor’s report may not have much effect on users, a qualified report would most probably affect users’ perception of its reliability.

4.2.6 Directors’ remuneration

In general, companies believe that it is important to disclose the total figure of remuneration given to directors as it explains how the earnings of the company are divided between the different stakeholders. However, one of the companies claimed that this information was not relevant to users and thus companies might as well not disclose it.
Only 42.86% of the companies, being two banks and an insurance company abide by Principle 8.10 and disclose the remuneration of each director separately (Figure 4.4). Respondents stated that the main reason for non-disclosure is that such information is commercially sensitive.

![Figure 4.4 Disclosure of directors’ remuneration](image)

Those companies which disclose the remuneration of each director separately believe that this disclosure should be made mandatory, since most of the other companies choose to opt out of this recommendation. Considering the arguments put forward on this matter (discussed in detail in Appendix D), it is felt that the ‘comply or disclose’ basis should be retained. While disclosure of individual directors’ remuneration could lead to misunderstandings by the users, and could even be deemed to be a breach of privacy, removing the requirement completely could be interpreted as a move away from transparency. Other alternatives are to have a remuneration committee composed of independent persons or to adopt the UK requirement to disclose the name of the consultant who advised the company on directors’ remuneration (Balachandran, 2006).
4.3 **The corporate governance statement and the users of financial statements**

85.71% of companies believe that the CGS is not widely read, resulting in a mean of 2.714. The other respondent stated that those who can influence the share price, including stockbrokers, analysts, banks, the MSE, the MFSA and auditors, do read the CGS.

### 4.3.1 Information disseminated through the CGS

Both listed companies and investors have varied perceptions as to what information the CGS provides. Table 4.2 shows the views of companies and investors respectively.

<table>
<thead>
<tr>
<th>Table 4.2</th>
<th>Perceptions of the information provided in the CGS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maltese Listed Companies</strong></td>
<td></td>
</tr>
<tr>
<td>Going concern and the level of attendance by directors at meetings</td>
<td></td>
</tr>
<tr>
<td>Performance of the enterprise and its objectives</td>
<td></td>
</tr>
<tr>
<td>Internal controls and details regarding committees</td>
<td></td>
</tr>
<tr>
<td>Company standards and adherence to principles (by two companies)</td>
<td></td>
</tr>
<tr>
<td>Compliance, transparency and accountability (by two companies)</td>
<td></td>
</tr>
<tr>
<td><strong>Investors</strong></td>
<td></td>
</tr>
<tr>
<td>Principles and recommendations to be followed by management</td>
<td></td>
</tr>
<tr>
<td>Full compliance with corporate governance reporting standards and guidelines</td>
<td></td>
</tr>
<tr>
<td>Internal control mechanisms and processes present within the company</td>
<td></td>
</tr>
<tr>
<td>Internal oversight processes</td>
<td></td>
</tr>
<tr>
<td>Reporting lines and independence of the board of directors from the management team</td>
<td></td>
</tr>
<tr>
<td>Composition of the Board and committees and remuneration of directors</td>
<td></td>
</tr>
</tbody>
</table>
Figure 4.5 shows the perception of listed companies and investors regarding whether the CGS provides information on short term or long term performance.

![Figure 4.5 Performance evaluation](image-url)

Most of the companies (42.86%) stated that the CGS provides information on short term performance, as they believe it is very difficult for a company to predict long term performance in the current, rapidly changing environment. The rest of the companies were equally divided between those who believe it provides information on medium term performance, and on both short term and long term performance. These results contrasted with users' views of the CGS, where none of them use it to obtain information on short term performance and half of them use it to assess long term performance. One of the investors stated that the CGS provides information on long term performance as it describes the company set up. Another investor stated the Principles seek to safeguard the long term
operations and the going concern of the entity and automatically ensure that short term considerations and issues are addressed. These findings show that companies and investors approach the statement with a different perspective.

4.3.2 User groups

Representatives of MLCs ranked user groups according to how much they believe they can benefit from the information disclosed in the CGS, as shown in Table 4.3.

<table>
<thead>
<tr>
<th>Users of financial statements</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investors</td>
<td>1.00</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td>Lenders</td>
<td>3.00</td>
<td>1.826</td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>5.14</td>
<td>1.773</td>
<td>0.000</td>
</tr>
<tr>
<td>Trade creditors</td>
<td>5.00</td>
<td>2.000</td>
<td></td>
</tr>
<tr>
<td>Customers</td>
<td>5.29</td>
<td>2.059</td>
<td></td>
</tr>
<tr>
<td>Government agencies</td>
<td>5.57</td>
<td>2.440</td>
<td></td>
</tr>
<tr>
<td>General public</td>
<td>5.86</td>
<td>1.464</td>
<td></td>
</tr>
</tbody>
</table>

It is evident that investors are perceived as benefiting the most from the CGS, followed by lenders, trade creditors, employees, customers, government agencies and the general public. Since the P value, obtained through the Friedman test is zero, the differences shown in the results are significant and not attributable to chance. They can thus be generalised.
4.3.3 Users’ needs

Although companies use a predefined format for the CGS, all interviewees claimed that they do consider users’ needs when preparing this report. Table 4.4 shows how users’ needs were ranked by companies according to the importance these are given and by investors according to which of these attributes the CGS provides to them.

<table>
<thead>
<tr>
<th>Table 4.4</th>
<th>Users’ needs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MLCs</td>
</tr>
<tr>
<td></td>
<td>Ranking</td>
</tr>
<tr>
<td>Understandability</td>
<td>1</td>
</tr>
<tr>
<td>Relevance</td>
<td>2</td>
</tr>
<tr>
<td>Comparability over time</td>
<td>3</td>
</tr>
<tr>
<td>Comparability with other firms</td>
<td>3</td>
</tr>
<tr>
<td>Other needs</td>
<td>4</td>
</tr>
</tbody>
</table>

All companies ranked either understandability or relevance first. 71.43% claimed that understandability is the most important factor because the information will be of no value to users unless it can be understood. The other 28.57% claimed that relevance is the most important factor as relevance determines whether users will pay attention to or ignore this statement. Stockbrokers, on the other hand, believe that the CGS primarily provides comparability with other firms, which was not given a high importance by companies.

Thus it is evident from these results and from those in Section 4.3.1 that MLCs and investors approach financial statements with a different frame of mind. It is possible,
therefore, that companies are not catering fully for the information needs of users when compiling the CGS. This addresses the third objective of this study.

All users interviewed agreed that an increase in the awareness of users’ needs would lead to an improvement in the CGS. This is understandable, given the low ranking the CGS received in section 4.2.4. If companies were to become more familiar with users’ needs, they would be able to tailor make the report to provide them with more useful information.

However, it seems that the majority of companies either believe they already know what users’ needs are, or would still disclose the same information if they had better knowledge of users’ needs, since only 42.86% of the companies believe that greater awareness of users’ needs would lead to an improvement in this report (yielding a mean of 3.857). This might indicate that although they may claim otherwise, the disclosure of the information in the CGS is done more for the sake of complying with regulations rather than to provide useful information to users. This finding relates to the fourth objective of this study.

4.4 Potential changes on reporting on corporate governance

This section tackles the fifth objective by analysing whether MLCs and investors believe that certain changes should take place to improve the current state of corporate governance reporting. Companies recommended making the report simpler and more user friendly and making the principles mandatory. 42.86% of investors also suggested that it should become simpler, possibly by decreasing the amount of disclosures and using layman terms. It was also suggested that companies should provide more information regarding the controls they have in place, especially given the current economic conditions. Investors argued that companies should disclose information about the nature and
frequency of briefings held with institutional investors and financial analysts, as well as disclosing the code of ethics or conduct applicable to their employees and officers.

### 4.4.1 Increase in the level of corporate governance reporting

Overall, companies believe that an increase in the level of corporate governance reporting would lead to the benefits shown in Table 4.5. Investors concur, except that they don’t believe it would be good for the financial markets and economic growth. Even where they agree, in general, they do so less strongly. This is further evidenced by the high standard deviation, indicating wide variability of opinion amongst the investor user group.
It is evident that the first 5 benefits are rated higher by listed companies than by investors. Conversely, the last benefit in the table is rated higher by investors rather than by MLCs. Although all the P values, obtained through the One-Way ANOVA test, exceed the 0.05 level of significance, implying that the mean rating scores provided by listed companies and investors for a particular benefit are equal, some of the P values are very close to 0.05, which may indicate a considerable difference in the evaluations between the 2 groups. This
is especially the case since the P value tends to be greater than 0.05 due to the small size of the population.

### 4.4.2 Changes in requirements

The following section deals with suggested changes to the CGS which were outlined in the literature review and lists and discusses the views of companies and where relevant of investors. In general, the views of respondents contrasted with the proposals. Stockbrokers disagreed with all the proposed changes, while companies disagreed with most of them (Table 4.6). These findings relate to the sixth objective of this study.
Companies disagreed with Baldacchino’s (2007) suggestion that they should divulge corporate governance information only when something exceptional occurs. Investors disagreed with this suggestion even more strongly. Both groups thus believe that it is important for companies to communicate with users on a yearly basis. It was pointed out that since shareholders change from one year to another, those who were not shareholders in previous years would have no information about governance unless the statement is presented every year. For other shareholders, it serves as a reminder of the corporate governance structure. In contrast, one of the companies which agreed with this proposition stated that such a change may lead firms to view the CGS as less of a burden and more of a necessary, value-adding disclosure.

<table>
<thead>
<tr>
<th>Table 4.6</th>
<th>Potential changes in requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
</tr>
<tr>
<td>a) Instead of disclosing the corporate governance statement every year, listed companies would give out information on corporate governance only if something exceptional occurs, such as a major change in controls or risks</td>
<td>Listed companies</td>
</tr>
<tr>
<td></td>
<td>Investors</td>
</tr>
<tr>
<td>b) A management specialist would be required to compile the corporate governance statement rather than having an auditor issue an opinion on such a statement</td>
<td>Listed companies</td>
</tr>
<tr>
<td></td>
<td>Investors</td>
</tr>
<tr>
<td>c) Certain committees should be made mandatory</td>
<td>Listed companies</td>
</tr>
<tr>
<td></td>
<td>Investors</td>
</tr>
</tbody>
</table>
b) Opinions varied as to the proposition that, rather than having an independent auditor’s opinion, an independent management specialist should be required to compile the CGS (Baldacchino, 2007). 57.14% of the companies disagreed with this proposition. Two of the companies which agreed suggested that rather than having one person responsible for the compilation of such a statement, or part thereof, it would be better to give this task to a group of persons external to the company in order to reduce subjectivity. Another company recommended that senior management should still be responsible for the compilation of this statement, while an external management specialist, rather than an auditor, would be required to give an opinion on this statement.

Investors disagreed much more strongly with this proposition with a mean of 1.67. This was because they believe that such management specialists, although in theory independent, may be biased due to their involvement with the firm, especially in cases of long association with it. They considered it preferable to have an independent auditor’s opinion. This contrasts with the conclusion as discussed in section 4.2.5 that they do not give a high value to the auditor’s opinion on the CGS. It might indicate that although little attention is given to the auditor’s opinion, they feel assured that the reporting of the company is being scrutinized by an independent auditor.

c) In general, companies do not believe that certain committees should be made mandatory. However, one of the companies stated that having certain committees helps avoid a situation where some individuals achieve dominance over the company.

Certain committees are useful for some organizations but not for others, such as small companies with less complex structures, or companies with a good balance between executive and non-executive directors. Thus, it would probably be better if this was left as a
recommendation and companies can decide whether it is beneficial for them to form such committees or not.

Companies recommended that if any, the nomination, remuneration and investment committees should be made mandatory, especially for companies of a certain size. Currently, companies that do not have such committees usually delegate these tasks to the audit committee. If such committees were to be set up, the audit committee would be able to focus on the tasks for which it is primarily responsible.

Investors agreed strongly (with a mean of 4.0) that some of the committees should be made mandatory. The main recommendations included the remuneration committee, the executive committee and the asset-liability committee.

The results may indicate that investors seek to obtain greater assurance to safeguard their investment, while being unaware of the additional costs that companies would have to incur to set up such committees. Companies thus seem to prefer to be able to decide which committees are more appropriate to the company.

i) Corporate governance committee

None of the companies interviewed have a corporate governance committee. This committee is found in the structure of various companies abroad and is mainly responsible for developing and implementing the company’s corporate governance guidelines, selecting board members, recommending directors’ remuneration and reviewing the board’ independence. When interviewed, 28.57% of the companies stated that they did consider setting up such a committee, however it was not thought to be necessary since its tasks are already carried out by the board or other committees (especially the audit committee, or the
remuneration and nomination committees where present). One respondent stated that it is better for these tasks to be divided between various committees, rather than having a centralized committee, since corporate governance relates to various different aspects within a company.

Another company said that setting up such committee was not deemed a top priority since the company was already bound by the listing rules. Another firm said that creating a large number of committees was not worthwhile as it would result in more people controlling than doing the work, and the tasks of the various committees could also clash with each other.

Some of the roles which are carried out by corporate governance committees, such as establishing a succession plan for senior management and the recruitment, training and motivation of executive officers and the management team are listed as principles of good corporate governance for the board of directors to carry out. So one can argue that although such companies do not have a corporate governance committee, the roles of such committee are still being carried out by the board or other committees.

ii) Corporate governance principles and mandatory requirements

Most of the companies disagreed strongly with a mean of 1.714 that the listing rules should be tightened and some of the principles made mandatory. Only one company believed that this suggestion would be helpful. Reasons given were that companies are already heavily regulated. Also, a company stated that if this change were to take place, it would make it more difficult for listed companies to compete with those which are not listed. The voluntary approach avoids such problems. This is consistent with the view of Sant (2003) that since companies have different structures and operate in various sectors, the same Code cannot be made mandatory for all listed companies. This is also consistent with what happened in
the US where the majority of US companies listed on the New York Stock Exchange are registered in Delaware which is less procedural than other state law in the US (Mallin, 2004).

71.43% of the companies do not feel that any of the principles of good corporate governance should be removed since they are currently on a ‘comply-or-disclose basis’. One of the companies suggested the removal of Principle 8.6.4 which recommends the disclosure of the remuneration of each director separately, while another suggested the removal of Principle 7 which recommends that the board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

All companies stated that if the CGS was not required by the listing rules, they would still choose to disclose it, as most of them believe it helps to improve transparency. It was also stated that being transparent may deter the possibility of fraud because one knows that he is being constantly surveyed. These results differ from the findings by Independent Audit (Evans, 2004 [online]), where it was found that most FTSE100 companies are only observing the principles of the Combined Code for the sake of compliance. Also, Šulenta, et al, (2005 [online]) observed that in Central European countries companies begin to report on their compliance with a code only when it becomes mandatory.

4.5 Conclusion

This chapter discussed and compared the views of MLCs and investors regarding the compilation and presentation of the CGS, and the regulations involved. It looked at whether changes in requirements are desirable in order to provide more useful information to
stakeholders in general, and investors and shareholders in particular. The next chapter presents the conclusions drawn by the author from this study.
Chapter 5

Conclusion
Chapter 5  Conclusion

5.1  Introduction

This chapter presents the main conclusions that can be drawn from this study and puts forward some suggestions for further research in this area.

5.2  Summary and conclusions

Corporate governance reporting is done by directors in order to provide stakeholders with information on how a company is governed. However, from this study it emerged that corporate governance information is not given much importance by investors in decision making. Since the CGS, when compared to other statements in the annual report, is not widely used for decision-making purposes, and given that the annual report is the main source of information on corporate governance, the implication is that corporate governance information does not play an important role in decision making. When making investment decisions, it seems that investors are more concerned with the operational results of the company than with the governance structure set up by the company to safeguard assets and achieve said results.

In the CGS directors state the level of compliance to the principles of good corporate governance and the effective measures taken during the period to ensure compliance with these principles. It was recommended to set up a help desk at the MFSA, manned by experts of the Code, who can assist companies in interpreting the principles, since 57.14%
of the companies stated that they have experienced difficulty in understanding certain critical issues of the Code, even with professional assistance.

The CGS was considered as value adding, in terms of the information it provides whether directly or indirectly, to the company. Although its compilation may pose a burden in terms of time and cost, it is still not considered to be a waste of time.

All companies claim that although they use a predefined format for the CGS, they consider users’ needs in its preparation. However, companies do not seem to be aware of users' needs since the needs that companies claim to be more important differ from those which users state are being satisfied through the use of this statement. Notwithstanding this, companies stated that greater awareness of users’ needs would not lead to an improvement in this report, possibly indicating that although they may claim otherwise, the preparation of the CGS is made more for the sake of compliance with regulations than with the aim of providing useful information to users. Also, investors expect to obtain different information through the CGS from that which MLCs believe it provides. Since, companies and investors approach the CGS with a different frame of mind, it is possible that companies are not catering fully for the information needs of users when compiling the CGS.

Mixed views were observed regarding whether an increase in the level of corporate governance reporting is desirable, with companies being more likely than investors to believe that such change is desirable. Investors disagreed that changes recommended in the literature for corporate governance reporting should take place, while companies disagreed with most of them.
5.3 Suggestions for further research

Recommendations for future research that could be carried out in related areas are mentioned below.

1) Alternatives to the CGS for reporting on corporate governance

This study mentions some of the alternatives that have been proposed with regards to corporate governance reporting. A more in-depth study could be conducted into these and other alternatives, so as to assess their viability and whether these proposals would lead to an improvement from the current state of corporate governance reporting. The perceptions of various stakeholders could be sought to determine the desirability of potential changes.

2) Perception of corporate governance reporting of users of financial statements

Due to time and word length constraints, the author had to focus mainly on the perception of MLCs and, to a more limited extent, the investor user-group. Further research could be conducted in order to assess in more detail the perception of investors and the other users of financial statements.

3) Case study of a listed company on all the means of communication it uses in order to provide stakeholders with information on corporate governance

Another study that could be carried out in this area is a detailed case study of the means of communication used by a particular company to disclose information on corporate governance. This would provide detailed knowledge on the process of collating, organizing and disseminating corporate governance information. The study could also look into the usage of such information by the company’s stakeholders.
Appendix A

Interview Schedule
Appendix A  Interview Schedule

A.  Regulations governing reporting on corporate governance

For the following questions, state the extent to which you agree with the statements.
[5 = strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree]

1. Disclosing all the required information in the corporate governance statement helps to convey a more positive image of the company

2. MFSA listing rules assist companies in improving corporate governance transparency and accountability to shareholders

3. a) Corporate governance principles rather than prescriptive rules make it easier for firms to comply with the substance of these principles

3. b) Principles rather than prescriptive rules are better for improving transparency

4. Do you believe that the Code in its present form is appropriate for the Maltese scenario?

5. a) In your opinion is the Maltese Code user friendly?

5. b) Have you ever experienced difficulty understanding certain critical issues?

B.  Reporting on corporate governance

6. a) Which of the following mechanisms does the company use to disseminate information about the entity’s corporate governance practices and standards?
Appendix A – Interview Schedule

Please tick where relevant

Annual report
Interim report
Preliminary announcements
Official statements
Company web site
Prospectus

b) Is there a difference in the corporate governance information disclosed in each of these reports? Why is this so?

7. Who is responsible for the compilation of the corporate governance statement?

8. On average, how much time is dedicated each year to the compilation of the corporate governance statement?

9. Is reporting on corporate governance seen as a burden or as a value adding activity? Can you mention some examples of added value? Eg improved overall financial accounting transparency, increase in stock prices.

10. Do you use the corporate governance statement of other listed companies as benchmarks for what you might be expected to disclose?

11. Do you see the corporate governance statement as an instrument to improve financial accounting transparency or as an additional traditional disclosure?

12. Does the company provide info on corporate governance over and above that required by the MFSA listing rules or recommended by the principles of good corporate governance?

13. a) How do you feel about the need to disclose the amount of remuneration given to directors?
Corporate Governance Reporting and its Significance in Maltese Listed Companies

State the extent to which you agree with these statements:

[5 = strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree]

b) if the company had the option it would choose not to disclose such information 5 4 3 2 1

c) a level of remuneration which is perceived by shareholders as being too high or too low may be interpreted incorrectly 5 4 3 2 1

C. The corporate governance statement and the users of financial statements

14. State the extent to which you agree with the following statement:

[5 = strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree]

Many users read the corporate governance statement 5 4 3 2 1

15. a) What information do you believe users are looking for when reading the corporate governance statement?

b) Does the information in the corporate governance statement give more information regarding short term or long term performance?

16. Rank these user groups according to how much they can benefit from the information disclosed in the corporate governance statement.

[1 = most important factor, 7 = least important factor]

Investors
Lenders
Employees
Trade creditors
Customers
Government agencies
General public
17. a) Do you keep in mind users’ needs when preparing the report, or do you follow a predefined format?

b) Rank according to the importance given to each of these needs:

[1 = most important factor, 5 = least important factor]

- Relevance to users’ needs
- Understandability
- Comparability over time
- Comparability with other firms
- Other needs

State the extent to which you agree with the following statements:

[5 = strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree]

c) An increase in the awareness of users’ needs would lead to an improvement in this report

    5 4 3 2 1

18. Can you recommend any changes that in your opinion would increase the readership of the corporate governance statement?

For the following questions, state the extent to which you agree with the statements.

[5 = strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree]

19. The auditor’s opinion on the corporate governance statement affects investors’ level of confidence in it and their perception of its reliability

    5 4 3 2 1

20. a) An increase in the level of corporate governance reporting would lead to the following benefits:

- help investors make better informed investment decisions
- enhance audit quality and the quality of financial reporting
- be good for the financial markets and economic growth
increase the confidence in the capital markets 5 4 3 2 1
increase the confidence in the financial reporting system of Malta 5 4 3 2 1
increase the confidence in the accountancy profession 5 4 3 2 1

b) Can you recommend any changes in order for these benefits to arise?

21. Indicate the amount of useful information each of these statements provides to users:

[5 = very important, 4 = important, 3 = moderately important, 2 = of little importance, 1 = not important]

The chairman’s review 5 4 3 2 1
Balance sheet 5 4 3 2 1
Income statement 5 4 3 2 1
Cash flow statement 5 4 3 2 1
Statement of changes in equity 5 4 3 2 1
Directors’ report 5 4 3 2 1
Auditor’s report 5 4 3 2 1
Corporate governance report 5 4 3 2 1
Other reports:
  Corporate social responsibility report 5 4 3 2 1
  Environmental report 5 4 3 2 1

D. Potential changes in requirements

For the following questions, state the extent to which you agree with the statements.

[5 = strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree]

22. Instead of disclosing the corporate governance statement every year, listed companies should give out information on corporate governance only if something exceptional occurs, such as a major change in controls or risks 5 4 3 2 1
23. An independent management specialist should be required to compile the corporate governance statement rather than having an auditor issue an opinion on such a statement 5 4 3 2 1

24. MFSA rules should be tightened, with some of the principles being made mandatory 5 4 3 2 1

25. a) Certain committees should be made mandatory 5 4 3 2 1
   (Note that currently only the audit committee is mandatory)

   b) Which committees would you propose to be made mandatory?

26. Would you prefer if some of the corporate governance principles recommended by the MFSA were to be removed? Which of these?

27. If the corporate governance statement was not required by the listing rules, would you still choose to disclose it?

28. Have you considered setting up a corporate governance committee which would be responsible for developing and implementing the company's corporate governance guidelines, electing board members, recommend directors' remuneration and review the independence of the board?
Appendix B

Questionnaire
Appendix B Questionnaire

A. Reporting on corporate governance

1. a) Which of the following mechanisms do you use to obtain information about the entity’s corporate governance practices and standards?

   Please tick where relevant
   - Annual report
   - Interim report
   - Preliminary announcements
   - Official statements
   - Company web site
   - Prospectus

   b) Which of the above tools provides the more detailed/useful information on corporate governance?

2. Do you see the corporate governance statement as

   a) an instrument to improve transparency
   b) or as an additional traditional disclosure?

Please tick the one with which you agree

B. The corporate governance statement and the users of financial statements

3. a) What information do you look for when reading the corporate governance statement?

   b) Does the information in the corporate governance statement give more information regarding short term or long term performance?

4. a) Do you think that the corporate governance statement provides these benefits?
Rank according to the importance given to each of these needs:

\[1 = \text{most important factor}, \ 5 = \text{least important factor}\]

Relevance to users’ needs
Understandability
Comparability over time
Comparability with other firms
Other needs

State the extent to which you agree with the following statements:

\[5 = \text{strongly agree}, \ 4 = \text{agree}, \ 3 = \text{neutral}, \ 2 = \text{disagree}, \ 1 = \text{strongly disagree}\]

b) An increase in the awareness of users’ needs would lead to an improvement in this report

5 4 3 2 1

5. Can you recommend any changes that in your opinion would increase the readership of the corporate governance statement?

For the following questions, state the extent to which you agree with the statements.

\[5 = \text{strongly agree}, \ 4 = \text{agree}, \ 3 = \text{neutral}, \ 2 = \text{disagree}, \ 1 = \text{strongly disagree}\]

6. The auditor’s opinion on the corporate governance statement affects investors’ level of confidence in it and their perception of its reliability

5 4 3 2 1

7. a) An increase in the level of corporate governance reporting would lead to the following benefits:

- help investors make better informed investment decisions
- enhance audit quality and the quality of financial reporting
- be good for the financial markets and economic growth
- increase the confidence in the capital markets
- increase the confidence in the financial reporting system of Malta
- increase the confidence in the accountancy profession
b) Can you recommend any changes in order for these benefits to arise?

8. Indicate the extent to which each of these statements provides useful information:

[5 = very important, 4 = important, 3 = moderately important, 2 = of little importance, 1 = not important]

The chairman’s review 5 4 3 2 1
Balance sheet 5 4 3 2 1
Income statement 5 4 3 2 1
Cash flow statement 5 4 3 2 1
Statement of changes in equity 5 4 3 2 1
Directors’ report 5 4 3 2 1
Auditor’s report 5 4 3 2 1
Corporate governance report 5 4 3 2 1
Other reports:
  Corporate social responsibility report 5 4 3 2 1
  Environmental report 5 4 3 2 1

For the following questions, state the extent to which you agree with the statements.

[5 = strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree]

C. Potential changes in requirements

9. Instead of disclosing the corporate governance statement every year, listed companies should give out information on corporate governance only if something exceptional occurs, such as a major change in controls or risks 5 4 3 2 1

10. An independent management specialist should be required to compile the corporate governance statement rather than having an auditor issue an opinion on such a statement 5 4 3 2 1
11. a) Certain committees should be made mandatory
(Note that currently only the audit committee is mandatory)

b) Which committees would you propose to be made mandatory?
Appendix C

Duties of Directors
Appendix C  Duties of Directors

Article 136A of Maltese Companies Act (1995) lays down the duties of directors. This article requires directors to act honestly and in good faith in the best interest of the company and promote the well being of the company by being responsible for the general governance of the company, including its administration and management, and supervising its affairs.

In particular directors shall:

- Exercise the degree of care, diligence and skill as would be expected from a diligent person taking into consideration the knowledge, skill and experience that the directors have and what would be reasonably expected from a person holding that position;
- Refrain from making personal gain from confidential company information, or make any profits without the consent of the company;
- Ensure that their personal interests do not conflict with the interests of the company;
- Not use any property, information or opportunity of the company for their own benefit or for the benefit of a third party, unless consent is given by the company at the general meeting or if permitted by the company’s memorandum or articles of association; and
- Exercise their powers only for the purposes for which these were given to them.
Appendix D

Disclosure of Directors’ Remuneration
Appendix D  Disclosure of Directors’ Remuneration

Those companies which disclose the remuneration of each director separately believe that this disclosure should be made mandatory, since most of the other companies choose to opt out. One of the banks pointed out that it is important to disclose the remuneration received by each director, especially after the recent banking crisis, in order to ensure transparency through proper disclosure of information.

One of the companies stated that disclosing the remuneration of directors separately breaches confidentiality and compared it to disclosing the remuneration of an employee. It was argued that this may lead directors to believe that an increase in remuneration will lead to negative repercussions. Another respondent commented that “users may be unable to understand that executive directors require a higher remuneration than non-executive directors or that there may be a particular director who is key to the business so he must be compensated”. In addition, it was pointed out that, given the pressure that regulations impose on directors, a company may be unable to employ competent directors unless it is willing to pay them a generous remuneration.

Thus, it might be preferable to mandate companies to have a remuneration committee composed of independent persons, responsible for setting directors’ remuneration. This avoids misinterpretations by shareholders who may lack the necessary knowledge to decide whether the wage levels are appropriate. However, removing the recommendation of disclosing the remuneration of each director separately may be considered as a move away from transparency, thus this recommendation could be left on a ‘comply or disclose’ basis.
The majority of MLCs (mean of 3.714) believe that a level of remuneration which is perceived by shareholders as being too high or too low may be interpreted incorrectly. One company pointed out that this depends on the nature of the minority shareholders; if they are companies themselves, such disclosure poses less of a problem as they are less prone to misjudgment. Individuals, on the other hand, may have less knowledge of the risks, responsibilities and duties of directors and may perceive certain packages as excessive. On the other hand a remuneration which is seen as too low can be interpreted as a risk that the directors will not give their full dedication, or that the company is unable to attract competent directors.

Another solution could be to adopt the UK requirement to disclose the name of the consultant who advised the company on the remuneration of directors, or the benchmark companies on which such remuneration packages were based. (Balachandran, 2006)
Appendix E   Covering Letter

28th October 2008

Dear Madam/Sir,

Ms Marvie Cauchi is a Bachelor of Accountancy (Hons) student reading through the last year of her course. As part of her academic studies and assessment, she is preparing a dissertation concerning ‘Corporate Governance Reporting and its Significance in Maltese Listed Companies’.

As part of her dissertation project, she is required to carry out a number of interviews and this is the purpose of this letter. You are kindly being asked to help Ms Cauchi and provide her with any information that you can offer.

The Faculty of Economics, Management and Accountancy of the University of Malta would be very pleased with your collaboration. All information will be treated with the strictest confidentiality.

Yours sincerely,

Ms Monique Micallef
Dissertation Supervisor
References


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