

**AUDIT COMMITTEES IN MALTESE  
LISTED COMPANIES AND THEIR  
PERCEIVED EFFECTIVENESS  
AN ASSESSMENT**

**BY**

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## **Abstract**

**TITLE:** Audit Committees in Maltese Listed Companies and their Perceived Effectiveness: An Assessment

**PURPOSE:** The objective of this study is to assess and analyse the effectiveness of ACs within MLCs with respect to the following five determinants: composition, authority and resources, diligence, internal audit contribution and assessment.

**DESIGN:** In order to ensure that the objective was achieved, this study adopted a qualitative mixed-method approach to collect data. Sixteen semi-structured interviews were conducted with ten MLC representatives, four EAs and two Regulators.

**FINDINGS:** The findings indicate that there is still some disagreement as to the extent of Maltese ACE. The appointment of AC members is left to the discretion of the Board which tends to appoint the NEDs to the AC without sufficient considerations for their competences and possibly their effective independence. Moreover, although financial competence is required on ACs, and formal qualifications are sought, there is as yet no statutory requirement for such qualifications. Additionally, ACs might be over-burdened with extremely varied objectives and with insufficient resources for them to reach all such objectives. AC meetings held by MLCs seem to surpass the minimum requirement stipulated by law and this is perceived to be contributing to their effectiveness. Moreover, although IAFs are seen as fundamental for ACs to reach their objectives, the lack of a statutory requirement to establish IAFs is probably negatively impacting ACE. Finally, although there seems to be a general opinion that AC assessment is necessary, the introduction of tighter regulation, such as a statutory requirement to introduce an independent third party in such process, is likely to encounter opposition.

**CONCLUSIONS:** This study concludes that, while Maltese ACs are generally effective, such effectiveness could be higher and certain determinants of ACE are as yet much less effective. Therefore, more needs to be done in terms of regulation and also in terms of better communication among the relevant parties.

**IMPLICATIONS:** This study sheds light on the somewhat ambiguous perceptions that seem to prevail regarding the effectiveness of Maltese ACs. It is hoped that the recommendations enable companies to derive more value from their ACs and to prompt regulatory authorities to specify additional guidance in certain areas.

**KEYWORDS:** Audit Committees, Audit Committee Effectiveness, Effectiveness Determinants, Maltese Listed Companies

**LIBRARY REFERENCE:** 20MACC039

## Dedication

*To Mum and Dad for helping me  
in all things, great and small*

## **Acknowledgements**

I would like to take this opportunity to express my deepest gratitude to all those who assisted and encouraged me throughout the course of this dissertation.

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# **Table of Contents**

Abstract.....	i
Dedication.....	ii
Acknowledgements.....	iii
Table of Contents.....	iv
List of Figures.....	ix
List of Tables.....	x
List of Abbreviations.....	xii
<b>CHAPTER 1: INTRODUCTION .....</b>	<b>1</b>
1.1    Introduction.....	2
1.2    Background to the Study .....	3
1.2.1    Introducing Audit Committees .....	3
1.2.2    Effectiveness Defined .....	4
1.2.3    The Development of Audit Committees.....	4
1.2.4    Audit Committees in Malta .....	7
1.3    Rationale for the Study .....	7
1.4    Objectives of the Study .....	8
1.5    Scope and Limitations .....	8
1.6    Overview of the Study .....	8
<b>CHAPTER 2: LITERATURE REVIEW.....</b>	<b>2</b>
2.1    Introduction.....	12
2.2    Audit Committee Effectiveness.....	13
2.3    Composition .....	15
2.3.1    Appointment of Audit Committee Members.....	15
2.3.2    Size of the Audit Committee.....	15
2.3.3    Audit Committee Member Expertise.....	16
2.3.4    Independence .....	17

2.4	Authority and Resources .....	18
2.4.1	Selection of the External Auditor .....	18
2.4.2	Overseeing the Financial Reporting Process .....	19
2.4.3	Monitoring Internal Controls and Risk Management Systems.....	20
2.4.4	Unrestricted Right to Resources .....	21
2.5	Diligence.....	22
2.6	Internal Audit Contribution .....	23
2.7	Assessment.....	23
2.8	Conclusion.....	24
<b>CHAPTER 3: RESEARCH METHODOLOGY .....</b>		<b>25</b>
3.1	Introduction.....	26
3.2	Secondary Research.....	28
3.3	Research Design.....	28
3.4	Research Tool .....	29
3.5	Research Participants .....	32
3.6	Data Collection .....	33
3.7	Data Analysis .....	34
3.7.1	Qualitative Data Analysis .....	34
3.7.2	Quantitative Data Analysis .....	34
3.8	Research Limitations.....	35
3.9	Conclusion.....	36
<b>CHAPTER 4: RESEARCH FINDINGS .....</b>		<b>37</b>
4.1	Introduction.....	38
4.2	Determinants of Audit Committee Effectiveness ( <i>Qn.1</i> ) .....	40
4.3	Composition ( <i>Qns.2 – 9</i> ) .....	42
4.3.1	Appointment of Audit Committee Chairperson .....	42
4.3.2	Benefits of Smaller Audit Committees.....	44

4.3.3	Benefits of Larger Audit Committees.....	45
4.3.4	Minimum Number of Audit Committee Members .....	47
4.3.5	Member Competence in Accounting and/or Auditing .....	49
4.3.6	Other Competences of Audit Committee Members.....	50
4.3.7	Formal Qualifications of Audit Committee Members .....	52
4.3.8	Independence of Audit Committee Members .....	53
4.4	Authority and Resources ( <i>Qns.10 – 13</i> ).....	55
4.4.1	Appointment and Oversight of External Auditors .....	55
4.4.2	Monitoring the Financial Reporting Process.....	56
4.4.3	Audit Committee’s Role in Risk Management Oversight.....	58
4.4.4	Right to Unrestricted Access.....	60
4.5	Diligence ( <i>Qns.14 – 16</i> ).....	61
4.5.1	Audit Committee Meetings .....	61
4.5.2	Audit Committee Meetings and Effectiveness.....	63
4.5.3	Regular Participants in Audit Committee Meetings .....	64
4.6	Internal Audit Contribution ( <i>Qn.17</i> ).....	66
4.7	Assessment ( <i>Qns.18 – 19</i> ).....	67
4.7.1	Audit Committee Self-Assessment.....	67
4.7.2	Optimal Method of Audit Committee Assessment.....	68
4.8	Overall Effectiveness of Audit Committees ( <i>Qn.20</i> ) .....	70
4.9	Conclusion.....	71
<b>CHAPTER 5: DISCUSSION .....</b>		<b>72</b>
5.1	Introduction.....	73
5.2	Composition – Taste .....	75
5.2.1	Is the Appointment of the Audit Committee Chairperson to be Regulated?.....	75
5.2.2	Audit Committees – Too Large or Too Small? .....	76
5.2.3	What is Financial Competence and is this Enough? .....	77
5.2.4	Member Independence – Fact or Fiction?.....	78

5.3	Authority and Resources – Sight .....	79
5.3.1	Authority – Is the Audit Committee Doing Enough? .....	79
5.3.2	Resources – Are they Adequate? .....	81
5.4	Diligence – Hearing .....	82
5.5	Internal Audit Contribution – Touch .....	83
5.6	Assessment – Smell .....	84
5.7	The Million-Dollar Question: Are Audit Committees in Maltese Listed Companies Effective? .....	85
5.8	Conclusion.....	86
<b>CHAPTER 6: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS.....</b>		<b>88</b>
6.1	Introduction.....	89
6.2	Summary .....	90
6.3	Conclusions.....	90
6.4	Recommendations .....	92
6.5	Areas for Further Research .....	95
6.6	Concluding Remarks .....	96

## **References**

General.....	R-1
Regulatory.....	R-7

## **Appendices**

Appendix 1.1 Maltese Equity-Listed Companies.....	A1.1-1
Appendix 3.1 Interview Schedule.....	A3.1-1
Appendix 3.2 Statistical Data Analysis using the Friedman Test.....	A3.2-1
Appendix 3.3 Statistical Data Analysis using the Mann-Whitney Test.....	A3.3-1
Appendix 3.4 Statistical Data Analysis using the Spearman Test.....	A3.4-1

## **List of Figures**

Figure 1.1: Outline of Chapter 1 .....	2
Figure 1.2: Outline of the Study.....	10
Figure 2.1: Outline of Chapter 2 .....	12
Figure 2.2: Four Dimensions of ACE.....	14
Figure 3.1: Outline of Chapter 3.....	27
Figure 4.1: Outline of Chapter 4 .....	39
Figure 5.1: The Five Senses of Effectiveness .....	73
Figure 5.2: Outline of Chapter 5 .....	74
Figure 6.1: Outline of Chapter 6 .....	89
Figure A3.1: Primary Components of ACE (Qn.1).....	A3.2-2
Figure A3.2: Appointment of AC Chairperson (Qn.2A).....	A3.2-3
Figure A3.3: Benefits of Smaller ACs (Qn.3).....	A3.2-4
Figure A3.4: Benefits of Larger ACs (Qn.4) .....	A3.2-5
Figure A3.5: Required and Actual Competences of AC Members (Qn.7) ..	A3.2-6
Figure A3.6: Problems due to Irregular AC Meetings (Qn.15B) .....	A3.2-7
Figure A3.7: Self-Assessment within ACs of MLCs (Qn.18) .....	A3.2-8

## **List of Tables**

Table 3.1: Interview Schedule Structure .....	30
Table 3.2: Combination of Open-Ended and Closed-Ended Questions .....	31
Table 3.3: Likert Scale .....	31
Table 3.4: Interviewees Participating in Research .....	33
Table 4.1: Primary Components of ACE (Qn.1) .....	40
Table 4.2: Process of Appointing an AC Chairperson (Qn.2.A) .....	42
Table 4.3: Advantages of Smaller ACs (Qn.3) .....	44
Table 4.4: Advantages of Larger ACs (Qn.4) .....	46
Table 4.5: Size Influences the Degree of ACE (Qn.5.A) .....	47
Table 4.6: Determinants of AC Size (Qn.5.B.iii) .....	48
Table 4.7: Sufficient Level of Accounting/Auditing Competence (Qn.6.A).....	49
Table 4.8: Required and Actual Competences of AC Members (Qn.7).....	50
Table 4.9: The Required Formal Qualifications of AC Members (Qn.8) .....	52
Table 4.10: Degree of Member Independence Influences ACE? (Qn.9.A).....	53
Table 4.11: Is a Separate Financial Reporting Committee Needed? (Qn.11.A)57	
Table 4.12: Arguments Relating to ACs Conducting Risk Oversight (Qn.12.A) 59	
Table 4.13: Adequateness of Resources in MLC ACs (Qn.13.C).....	61
Table 4.14: Are AC Meetings in MLCs Sufficient? (Qn.14.C).....	62
Table 4.15: AC Meetings and Effectiveness (Qn.15) .....	63
Table 4.16: Regular Participants in AC Meetings (Qn.16.B) .....	65
Table 4.17: Effectiveness of the Internal Audit Contribution (Qn.17.B) .....	67
Table 4.18: Self-Assessment within ACs of MLCs (Qn.18) .....	68
Table 4.19: Optimal AC Assessment (Qn.19) .....	69
Table 4.20: Perceived Effectiveness of ACs in MLCs (Qn.20) .....	70

Table 5.1: Strength of Relationship with Qn.20 .....	85
Table A3.1: Process of Appointing an AC Chairperson (Qn.2.A) .....	A3.3-2
Table A3.2: Competences of AC Members (Qn.7).....	A3.3-3
Table A3.3: Sufficiency of the Resources of MLC's ACs (Qn.13.C) .....	A3.3-5
Table A3.4: Frequency of AC Meetings (Qn.15) .....	A3.3-6
Table A3.5: Strength of Relationship with Qn.20.....	A3.4-2

## **List of Abbreviations**

AC	Audit Committee
ACE	Audit Committee Effectiveness
Board	Board of Directors
CFO	Chief Financial Officer
CG	Corporate Governance
EA	External Auditor
EP	European Parliament
EU	European Union
FRC	Financial Reporting Council
IA	Internal Auditor
IAF	Internal Audit Function
IC	Internal Control
INED	Independent Non-Executive Directors
IT	Information Technology
MLC	Maltese Listed Company
MSE	Malta Stock Exchange
NED	Non-Executive Director
RM	Risk Management
SEC	Securities and Exchange Commission
SOX	Sarbanes-Oxley Act
SSI	Semi-Structured Interview
UK	United Kingdom

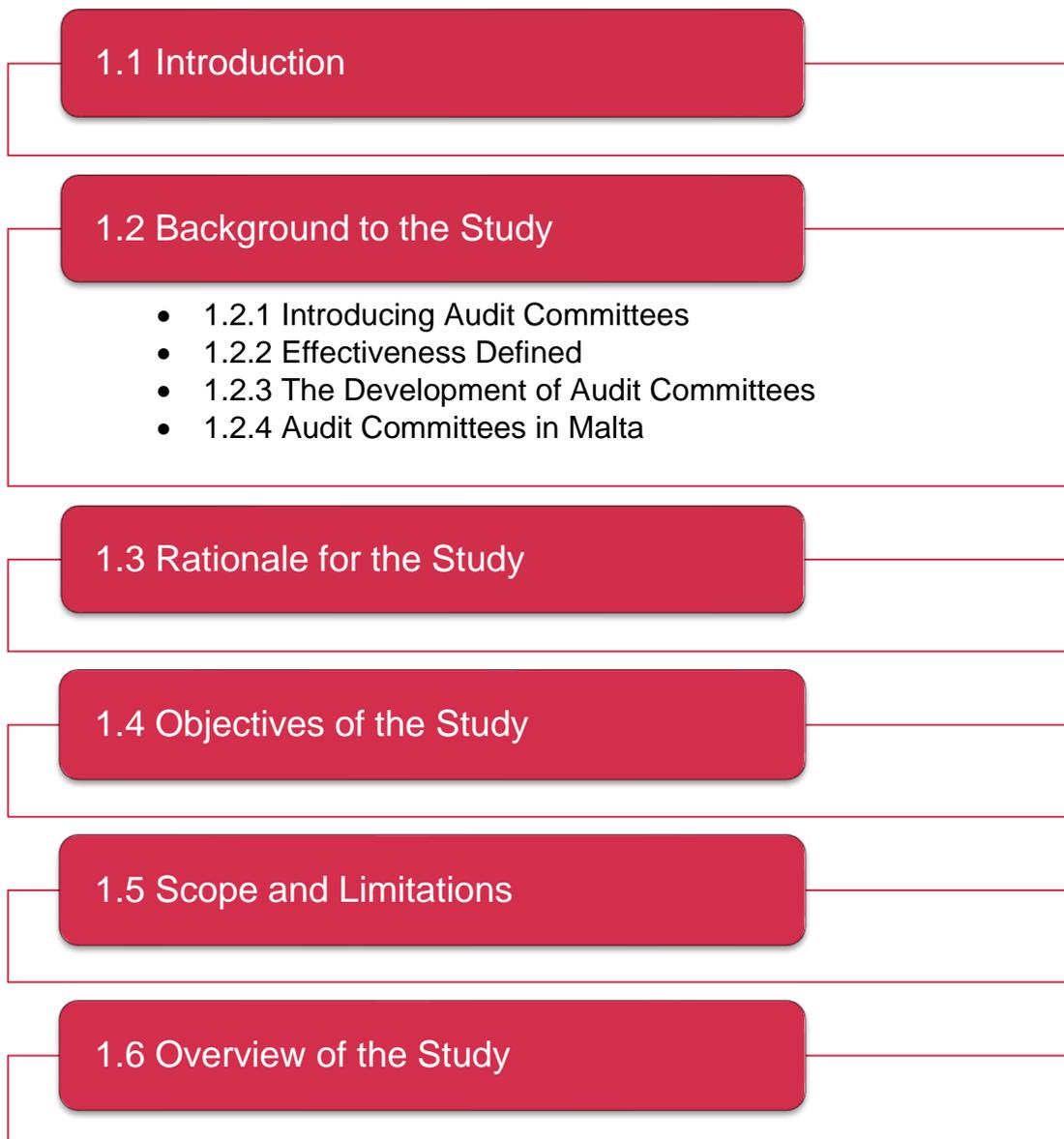
# **INTRODUCTION**

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## **CHAPTER 1**

## 1.1 Introduction

This chapter aims to provide an introduction to the dissertation. As seen in Figure 1.1, Section 1.2 introduces audit committees (ACs) and defines effectiveness, Section 1.3 then presents the rationale for this study, Section 1.4 sets out the objectives of the study and Section 1.5 highlights the scope and limitations. Section 1.6 then concludes with a depiction and explanation of how the dissertation is structured.



*Figure 1.1: Outline of Chapter 1*

## 1.2 Background to the Study

### 1.2.1 Introducing Audit Committees

ACs have been part of the governance structure of firms since the early 20<sup>th</sup> Century (Birkett 1986). However, due to several huge corporate failures in the last three decades, including those of Baring Bank, WorldCom and Enron, several regulatory reforms have taken place which, among others, enhanced and strengthened the duties and functions of the AC (Vera-Muñoz 2005). The Sarbanes-Oxley Act (SOX) (Sarbanes 2002), within section 2 paragraph 3(A), defines an AC as:

*“A committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer.”*

Therefore, an AC is a committee composed of directors whose role is to monitor how the organisation is *“controlled, reported on and conducted”* (Kaur 2011, p.28). As such, the AC is now a formal sub-committee of the Board of Directors (Board) which holds a crucial role in the corporate governance (CG) of the organisation and in aiding the directors to perform their responsibilities (Kaur 2011). In fact, in their guidance to ACs, the European Confederation of Directors' Associations (ECODA) and PricewaterhouseCoopers (PwC) (2016) further emphasised that ACs are a crucial body to ensure robust CG within an organisation. As John Ormerod, Chairman of the AC of ITV plc said *“A core objective of the AC is to help the business operate successfully”* (European Confederation of Institutes of Internal Auditing, Federation of European Risk Management Associations [ECIIA, FERMA] 2014, p.8). Therefore, the AC must assist the Board in achieving its roles within CG through;

- i. Obtaining sufficient knowledge on the structure, controls and transactions of the firm together with its related risks,
- ii. Upholding continuous communication with both the external auditors (EAs) and internal auditors (IAs), the *“second line of defence”* as well as management; and

- iii. Gaining the right to examine any matter through unfettered access to the documents, operations and company personnel. (ECIIA, FERMA 2014, p.8)

For the AC to be able to deliver such assistance to the Board, management is duty-bound to keep the AC adequately abreast by providing it with applicable and complete information (ECIIA, FERMA 2014). Moreover, the AC must have unrestricted access to any information it may require, absolute authority to examine any issues within its remit, together with the resources required to do so (Cadbury 1992).

### **1.2.2 Effectiveness Defined**

Cambridge dictionary defines effectiveness as *“the ability to be successful and produce the intended results”* (Cambridge University Press 2019). The Institute of Chartered Accountants in England and Wales (2003) further clarifies that effectiveness may be viewed as a combination of quality control, expertise as well as quality assurance. Although, there is a clear definition in the English language, Bender (2006, p.1) argues that effectiveness may be said to be in the *“eye of the beholder”* as it carries different meanings depending on the situation and the point of view. As such, the effectiveness of ACs will be discussed further in Chapter Two.

### **1.2.3 The Development of Audit Committees**

The first formal ACs were recommended as part of the governance structure of firms in 1939 by the Securities and Exchange Commission (SEC) and New York Stock Exchange following the McKesson and Robbins scandal in America (Birkett 1986, Spira, 2006, Vera-Muñoz 2005). Later on, in 1972, the SEC advised that, all publicly listed companies should establish an AC, stating that such a proposal was intended to ensure the EA’s responsibilities to investors, in particular that of independence (Birkett 1986).

Primarily, the SEC had recommended that an AC should be set up, consisting of non-executive directors (NEDs) however, no strict guidance was given as to its size (Birkett 1986). The SEC then specified that among other things, the AC should review the remits of the audit and the audit fee, communicate with the EA and the firm's chief financial officer (CFO) with regards to the internal controls (ICs) and advise the Board on whether to retain or change the EA (ibid.).

In Europe, such committees were developing slower than in America. There is some evidence dating back to the 19<sup>th</sup> century in the United Kingdom (UK), which indicates that the Great Western Railway Company had some type of primitive AC (Spira 2006). However, it was not until 1992 that the Financial Aspects of Corporate Governance Committee, which became known as the Cadbury Committee, recommended that ACs form part of the CG structure of firms in the UK (Sulaiman 2017).

Similar to the SEC's recommendations, the Cadbury Committee proposed that ACs should be established of at least three NEDs, the majority of which should be independent of the firm (Cadbury 1992). With regards to the functions of the AC, the Cadbury Committee stated that among other issues, it was to assist the Board in the selection of the EA and the determination of the audit fee, communicate with the EA with regards to the remit of the audit and review the firm's ICs (ibid.).

As previously discussed, the significant corporate scandals of the 20<sup>th</sup> century spurred certain changes in the business world, among which was the role and responsibilities of the AC. ACs were put under much more scrutiny and had their functions redefined and improved. In fact, their responsibilities changed dramatically during the years 1999-2002 with two major regulatory reforms; *"the 1999 Blue Ribbon Committee's (BRC) – Report and Recommendations on Improving the Effectiveness of Corporate ACs"* and *"the Corporate and Criminal Fraud Accountability Act of 2002"*, more commonly referred to as the SOX (Vera-Muñoz 2005, p.116). The BRC report emphasised that the initial step to

developing AC guidelines is to first recognise the AC's position as part of the overall CG structure, since it is concerned with the oversight of financial reporting (BRC 1999). It is not, however, the role of the AC to actually prepare the financial statements as this responsibility lies with management. Therefore, an appropriate and effective system exists when the Board along with the AC, financial management together with internal and external auditors constitute a "*three-legged stool*" responsible for financial reporting (BRC 1999, p.1071).

The SOX brought about more clarity in the committee's role and powers, as well as elevated the AC composition requirements to consist of more independent directors. Moreover, it stipulated that at least, one member of the AC should be a "*financial expert*" by having a qualification and experience as an accountant, auditor or chief financial or accounting officer (Sarbanes 2002, sec.407). In return, the SEC and the U.S. stock exchanges put forward new laws regarding ACs, which included: the responsibility for pre-authorisation of both audit and non-audit services, the oversight of the EA's engagement and remuneration, together with receiving and handling employee complaints (Vera-Muñoz 2005).

Following the financial crisis of 2007-2009, regulatory agencies have given much more importance to promoting and enhancing the role of ACs within organisations. Most countries worldwide nowadays see the AC as an integral component of the CG process and expect PIEs to incorporate it, whether by statute, rules or recommended guidance notes. Moreover, the autonomy of the AC is essential to enable the EA to share certain information, which they may not want to disclose to the Board (Association of Chartered Certified Accountants 2011). Consequently, the EU also felt the need to implement certain regulations to clarify the composition and responsibilities of the AC following such a catastrophic event. As such, the EU, through the European Parliament and the Council of Ministers, issued provisions targeting ACs within both Directive 2014/56/EU (the Directive) and Regulation (EU) No. 537/2014 (the Regulation) (Federation of European Accountants [FEE] 2016). These provisions replaced the 2006 statutory audit directive (SAD). The Directive and the Regulation, often

referred to as the 'audit reform', provide for more extensive responsibilities of the AC which tend to focus on fundamental areas of CG (FEE 2016).

#### **1.2.4 Audit Committees in Malta**

As discussed in the previous section, ACs have been around for quite some time however, they are more of a new concept in Malta. When the Listing Rules were established in Malta in 2005, ACs were made mandatory for all listed entities (Camilleri 2016). With the first introduction of the AC, several argued that these were a "*rubber stamp*" as they simply endorsed the Board's decisions (Borg 2007, p.47). With the passage of time and experience, businesses started to gauge the importance of having an AC and so their significance and functions within an organisation began to increase (Borg 2007). The composition and effectiveness of ACs will be explored further in Chapter Two.

### **1.3 Rationale for the Study**

The AC is an integral and essential part of the CG of an organisation. Its function is essential for a company to perform well and ensure its long-term standing. Moreover, it has been argued that certain corporate failures which happened during the past three decades could have possibly been avoided or their implications reduced had there been the appropriate oversight and governance, which the AC can help to implement (Vera-Muñoz 2005). Therefore, a number of new regulations and guidelines have been issued which enhance the responsibilities of the AC, especially since the financial crisis. It is thus worthwhile to obtain a thorough understanding of the performance, effectiveness and applicability of such laws and regulations in the Maltese scenario, particularly because studies show that Maltese companies tend to perceive audits – and specifically, internal audits – as an added overhead expense of the company, rather than a value-adding activity (Farrugia 2006).

Several studies have been conducted in the local scenario which target the functioning and effectiveness of ACs. However, these have all been carried out prior to the EU's audit reform which occurred in 2016. Moreover, the studies

conducted were mostly restricted to a particular sector of the economy. Therefore, such a study would be essential to try to understand the implications that the audit reform had on Maltese audit committee effectiveness (ACE) and look at ACs in a more comprehensive manner.

## 1.4 Objectives of the Study

The primary aim of this study is to assess and analyse the effectiveness of ACs within Maltese Listed Companies (MLCs)<sup>1</sup>. To achieve this, this study will assess the effectiveness of Maltese ACs with respect to the following determinants:

- a. Composition
- b. Authority and Resources
- c. Diligence
- d. Internal Audit Contribution
- e. Assessment

## 1.5 Scope and Limitations

The scope of this study focuses on five major ACE determinants. However, this must not be taken to imply that other possible factors, such as the member diversity, bear no influence at all on ACE.

Furthermore, this study encompasses Maltese and foreign information and circumstances applicable up to 31<sup>st</sup> March 2020.

## 1.6 Overview of the Study

**Chapter One** introduces the research study and presents some background information on the topic. This preliminary chapter also provides a rationale for the study, sets out the objectives and discusses the limitations of the study.

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<sup>1</sup> Vide Appendix 1.1

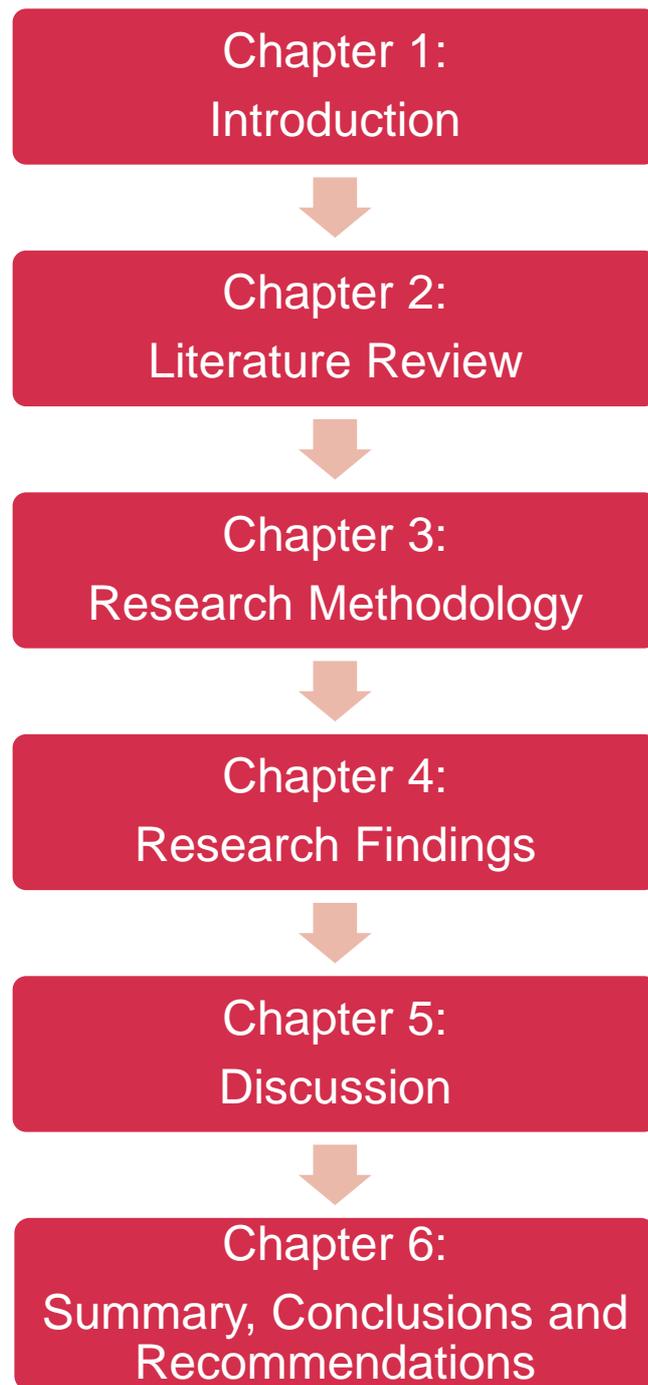
**Chapter Two** presents a comprehensive review of existing foreign and local literature in relation to ACs and their composition. This chapter also analyses the different regulatory reforms which have impacted ACs.

**Chapter Three** outlines the research methodology adopted to be able to achieve the research objectives of the current study.

**Chapter Four** presents the research findings obtained from semi-structured interviews conducted in the study.

**Chapter Five** provides an in-depth analysis and discussion of the research findings presented in Chapter Four.

**Chapter Six** concludes the research study by putting forward the key findings and recommending a number of areas for further research. Figure 1.2 overleaf illustrates the outline of the study.



*Figure 1.2: Outline of the Study*

# LITERATURE REVIEW

---

## CHAPTER 2

## 2.1 Introduction

This chapter provides a comprehensive evaluation of both foreign and local existing literature on the research topic. As seen in Figure 2.1 below, Section 2.2 discusses ACE in some detail. Then, Section 2.3 evaluates the composition, Section 2.4 delves into the authority and resources of ACs. Section 2.5 evaluates the aspect of diligence, Section 2.6 analyses the internal audit contribution and Section 2.7 evaluates the assessment procedures. Finally, Section 2.8 concludes the chapter.



Figure 2.1: Outline of Chapter 2

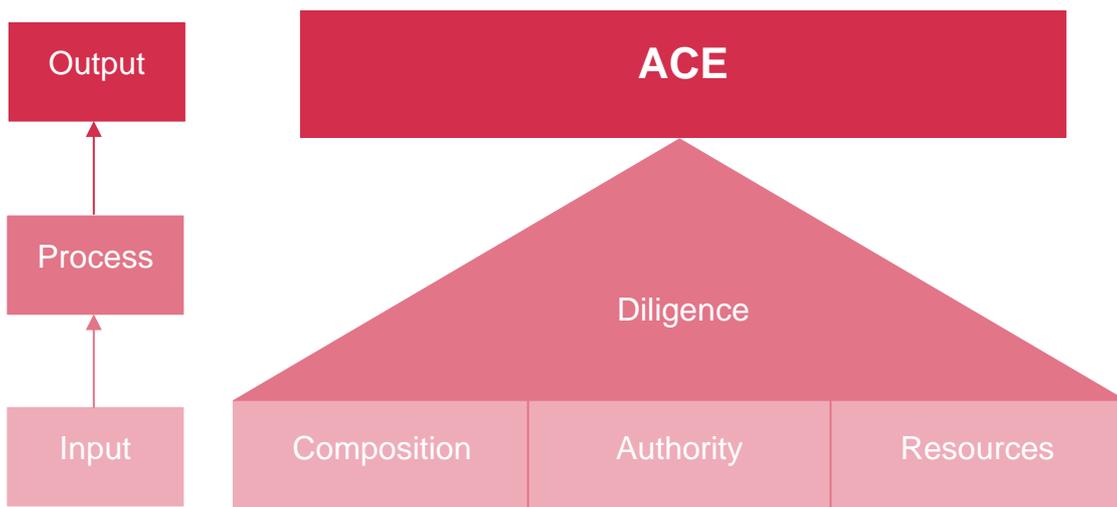
## 2.2 Audit Committee Effectiveness

According to Kalbers and Fogarty (1993) effectiveness is seen as the technique and skill with which the AC undertakes its distinct monitoring roles. In fact, later, DeZoort, Hermanson et al. (2002, p.41) defined ACE as follows;

*“An effective audit committee has qualified members with the authority and resources to protect stakeholder interests by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts.”*

Several studies have been conducted in relation to ACE and all conclude that there are a number of factors which influence the degree of ACE. Such factors include: the size of ACs, the degree of independence of its members, the chairpersons' level of financial expertise, the frequency of the AC's meetings and the willingness of AC members to confront managers (Akhtaruddin, Haron 2010, Buallay 2018, Cohen, Krishnamoorthy et al. 2004, DeZoort et al. 2002, Li, Mangena et al. 2012).

After evaluating the principle determinants of ACE, DeZoort et al. (2002) very effectively summarised the most prominent ones into four dimensions which influence ACE. The four dimensions are: Composition, Authority, Resources and Diligence (DeZoort et al. 2002). As depicted in Figure 2.2 overleaf, the composition, authority and resources available to the AC will form the steady base for the AC to function effectively and are, as described by DeZoort et al. (2002, p.42), the *“basic inputs”* necessary to achieve effectiveness. On the other hand, diligence is the process through which the AC transforms these given inputs into the necessary work needed to be effective committees for their firms.



*Figure 2.2: Four Dimensions of ACE*  
 Source: Adapted from DeZoort et al. (2002, p.43)

Moreover, communication with and access to the IA is seen as one of the most important resources available to the AC to be able to execute its functions (Audit Committee Institute [ACI] 2017). It falls upon the AC to establish and maintain a culture in which the IA feels free to openly discuss matters with the AC, especially if obtaining the support of management would not be possible (BRC 1999). This relationship with the IA and internal audit function (IAF) as a whole becomes even more important as the business expands (Braiotta, Gazzaway et al. 2010). Therefore, the internal audit contribution is considered to be another determinant of ACE.

Finally, a regular assessment of the AC is needed to determine whether it has been effective in meeting its objectives. Such continuous assessment may highlight ways in which the AC might enhance its effectiveness and also identify any lack of information and competence within the AC (ACI 2017). As such, the assessment of the AC is also considered to be a determinant of ACE. This is discussed further in Section 2.7.

## 2.3 Composition

In order to meet the needs of all interested parties in the firm, the AC must undertake its oversight role in an effective and efficient manner and thus, its composition and formation are of utmost importance (Ferreira 2008). In fact, Bromilow and Keller (2011) argue that the degree of ACE depends primarily on the structure and communication between its members.

### 2.3.1 Appointment of Audit Committee Members

The Maltese Listing Rules specify the requirements that need to be adhered to when setting up and sustaining an AC by mandating that it “*should be composed entirely of NEDs and having at least three (3) members*” (Listing Authority – Malta 2019, S5.117.1). According to Collier (1993), in various corporations, the NEDs are immediately appointed as part of the AC and remain members as long as they remain on the Board. On the other hand, the AC’s chairperson is chosen by the Board or else recommended by the AC and officially appointed by the Board (Camilleri 2016, Collier 1993).

However, in its guidance to ACs, the Financial Reporting Council (FRC) (2016) specified that it is the responsibility of the Board to appoint members to the AC from the nominees put forward by the Nomination Committee. Since such Committee holds a prominent position within the organisation, it would retain the sufficient knowledge to decide what is best for the company (Baldacchino, Gatt et al. 2018) and may also consult with the AC chairperson about prospective members. Furthermore, the FRC (2016, p.3) goes on to state that in considering who to appoint to the AC, the Board shall keep in mind the “*range of skills, experience, knowledge and professional qualifications*” needed for it to be able to function effectively and efficiently.

### 2.3.2 Size of the Audit Committee

As mentioned in the previous section, the Listing Rules specify that an AC should be composed of at least three members. In fact, Camilleri (2016) as well as

Micallef (2015), concluded that Maltese ACs comprise between three to six members depending on the size of the company in question. Although there is a minimum requirement in this regard, some studies argue that larger ACs might be more effective. Karamanou and Vafeas (2005) as well as Camilleri (2016) claim that ACs with more members theoretically would have a wider degree of expertise and skills to draw from. On the other hand, Beasley's (1996) results seemed to suggest that, in fact, larger ACs are more ineffective than smaller ones. Bédard, Courteau et al. (2004) support this by stating, that it would still be possible for the AC to carry out effective monitoring even if it were composed of fewer than three members, say two members. To this effect, Karamanou and Vafeas (2005) continue to argue that larger ACs might, in fact, suffer from process inefficiencies and dispersion of power, thereby rendering them less effective than smaller ones.

Furthermore, the composition of the AC is also likely to influence the number of meetings. As the number of members increases, it is probable that more issues arise, requiring further discussion and thus further meetings (Raghunandan, Rama 2007). Moreover, larger ACs contribute more oversight and thus, require further meetings to review and assess the financial report's quality (Al-Najjar 2011).

### **2.3.3 Audit Committee Member Expertise**

Listing Rule 5.117 paragraph 3 continues to specify that *"at least one member of the audit committee shall be competent in accounting and/or auditing"* but provides no further clarification as to what level of competence would suffice (Listing Authority – Malta 2019). The BRC (1999), in its report addressed to ACs to help improve their effectiveness, defined expertise as previous employment in accounting, having an academic certificate in accounting or anything similar which allows the understanding of the core financial statements. Micallef (2015, p.62) agrees with the BRC and states that such a criterion is *"not only satisfied by an accountant, but by an individual with a financial mind"*. The rationale of having a financial expert on the committee is that the members would be in a

better position to comprehend the judgements passed by the auditor and to rectify any dispute between internal management and the EA (Mangena, Pike 2005). DeZoort et al. (2002) in fact, go on to say that AC member expertise is an essential prerequisite for ACE.

Moreover, with the EU's audit reform, the European Parliament (EP) set out a new requirement with regards to the composition of ACs. In this regard, Listing Rule 5.118 states that the AC "*as a whole*" should be competent in the specific sector in which the firm is operating (Listing Authority – Malta 2019). The fact that the legislation specifies that it is the AC 'as a whole' which needs to satisfy this requirement is very important, as it implies that not all members need to be knowledgeable in the sector. Indeed, a number of ACs actually have members proficient in other sectors in order to widen their knowledge base and skills (ECODA, PwC 2016). In order to assess whether this requirement is satisfied, the FEE (2016) suggest that the shareholders of the firm should analyse whether the AC, as one committee, would manage to comprehend the complexities presented by that industry.

### **2.3.4 Independence**

It is necessary that the AC is independent of the firm and its management in order to execute its monitoring role and safeguard shareholders' interests (Bédard et al. 2004). Camilleri (2016) agrees, stating that an independent member would be unrestricted to freely discuss all issues without feeling obliged toward certain individuals. The independence of the AC is, first and foremost, affected by the proportion of executive and NEDs, its chairperson and the independence of each and every member (Ferreira 2008). In fact, more than half of the AC members should be independent of the organisation (Listing Authority – Malta 2019, S5.117.2). However, both the Directive and the Regulation fail to clarify what makes an AC member independent. The FEE (2016, p.11) states that such a determination should be "*principles-based*" and argues that the Board may look at whether that member: has any economical or personal relationship with management, is a close family member of the top management of the firm or has

a significant business relationship with the firm itself, among other criteria. Moreover, Ferreira (2008) argues that 'independence' is of such importance that it should be the principal condition when appointing new AC members.

There are also certain other conditions which might exist and limit the independence of directors. A NED may enter into a "*fiduciary relationship*" with management, thus becoming dependent on them. Such relationships tend to hinder the NED's ability to critically assess decisions taken by management (Vafeas 2001, p.198).

## **2.4 Authority and Resources**

The authority of the AC is essentially a result of its "*responsibilities and influence*". Such authority is drawn from three main sources, which are the Board itself, the listing rules and the law applicable in the specific country (DeZoort et al. 2002, p.44). AC's roles and responsibilities are always evolving and increasing and so is its authority (DeZoort et al. 2002). However, the fundamental responsibility of the AC is to safeguard the interests of shareholders and aid the Board in carrying out their function in an effective and efficient manner (Listing Authority – Malta 2019, S.5.126). In order for ACE to be amplified, the Board must draw up a formal explanation of the AC's roles and authority. Only once the AC has a clear mission, does it serve the company in the best way (Braiotta et al. 2010).

### **2.4.1 Selection of the External Auditor**

Regulatory agencies in America were of the opinion that EA's independence is jeopardised if management is in charge of appointing, retaining and deciding the fee of the auditor, since auditors might be pressured to serve management rather than the shareholders (Dhaliwal, Lamoreaux et al. 2015). In fact, with the enactment of the SOX in 2002, the AC became "*directly responsible for the appointment, compensation and oversight*" of the EA (Sarbanes 2002, sec.301). Within the EU, the EP, through the Regulation, made the AC responsible for recommending to the Board a suitable EA for the entity. In its recommendation,

the AC needs to put forth a minimum of two EAs and highlight its preferred one with suitable justification (FEE 2016). Moreover, Listing Rule 5.127.5 mandates that the AC is responsible for overseeing the independence of the EA giving particular attention to “*non-audit services*” provided by the EA to the firm (Listing Authority – Malta 2019). The FEE (2016) suggests that the AC should pre-set a threshold below which its authorisation would not be necessary to approve non-audit services. However, if the threshold is exceeded then its involvement in approving the service would be mandatory.

Although the provisions within SOX were intended to diminish the impact of management association in the auditor selection process, Dhaliwal et al. (2015) found that management affiliation still impacted this process substantially in the post-SOX period. Such results are consistent with Looknanan-Brown (2011) who found that an EA previously affiliated with management was more likely to be chosen by the AC.

#### **2.4.2 Overseeing the Financial Reporting Process**

Under Listing Rule 5.127.1 the AC is also responsible for “*monitoring the financial reporting process and submitting recommendations or proposal to ensure its integrity*” (Listing Authority – Malta 2019). The business world is all the time evolving and with it, so is the intricacy and width of financial reporting. Whereas it is management’s responsibility to ensure that the financial reports are true and fair, it is the AC’s role to ascertain that management is upholding its duties (Braiotta et al. 2010). The AC should ensure that the process is adhering to the applicable accounting framework and that all necessary disclosures have been included (Camilleri 2016). To carry out this function, the AC may start by gaining insight into the sector, geography and business of the company and then move on to ensuring that the people employed to draw up these statements have the adequate knowledge and skill to do so (Braiotta et al. 2010). The rationale behind such a function is that effective monitoring of the reporting process by the AC should lead to better quality and timely disclosure of financial information (Rochmah Ika, Mohd Ghazali 2012). In essence, the AC must evaluate that the

financial statements are clear, complete and transparent for the users to be able to understand them and to make appropriate decisions based on the information provided.

To be able to perform this role appropriately, management needs to keep the AC informed with any changes in the standards used and the treatment of complex transactions (ACI 2017). As such, an efficient “*two-way dialogue*” needs to be present between the AC and the CFO, however the AC may also make use of the EA’s support in recognising issues of quality and reliability in the financial statements (ACI 2017, p.70). If any part of the financial reporting process fails to satisfy the AC, then it should report this to the Board (FRC 2016).

### **2.4.3 Monitoring Internal Controls and Risk Management Systems**

The ultimate responsibility of monitoring ICs and risk management (RM) systems lies with the Board, however, the Board may decide to entrust the AC to assist in meeting this function (FRC 2016). The Listing Rules go a step further as to mandate this as one of the responsibilities of the AC with the ultimate clause that, the AC must carry out such role without infringing on its independence (Listing Authority – Malta 2019). To be able to monitor ICs effectively, the AC should be aware of the processes that management have designed and implemented and understand whether these are operating as they should be (Bujno, Hitchcock et al. 2018).

In relation to RM, normally the AC would not have the expertise to oversee all the risks, prompting the Board to delegate them to different committees. However, the AC should have a fundamental role in monitoring financial risks. With financial risk comes fraud risk and although it is not the function of the AC to identify and prevent fraud risk, it should supervise and be satisfied with the antifraud IC systems put in place by management (Bujno et al. 2018).

The AC should pass its recommendations to the Board with respect to the disclosures on ICs and RM within the annual report (FRC 2016). It is important to note however that, more companies, especially large firms, public organisations and financial services firms are now creating a “*management-level risk committee*” and delegating the oversight of RM process to this committee rather than to the AC (Beasley, Branson et al. 2019, p.3).

#### **2.4.4 Unrestricted Right to Resources**

Adequate monitoring hinges on the AC having the necessary resources it needs to fulfil its function (DeZoort et al. 2002). The FRC (2016) states that all the required resources must be provided to the AC for it to perform its function. The basic resources that the AC needs to function include financial as well as other information and it is essential that the AC has full and unrestricted access to such information. Such resources must be made available well in advance of the scheduled meetings to allow enough time for members to analyse and assess the information (Braiotta et al. 2010). DeZoort et al. (2002) postulate that a reasonable number of meetings together with access to the Board, management, EAs, IAs and the firm’s legal counsel are among the resources required by the AC.

Furthermore, a strong relationship between the EA and the AC aids both parties in undertaking their responsibilities (FEE 2016). The BRC (1999) argues that only through continuous and confidential communication with the EA, can the AC make use of the information gathered through the statutory audit, especially with regards to ICs. To this effect, the 2006 SAD made it a requirement that the EA presents a report to the AC explaining the results of the external audit. Such a prerequisite was further enhanced through the Regulation (FEE 2016). To help improve such a relationship, the FEE (2016) also suggests that the EA is invited to be present at the AC’s meetings.

## 2.5 Diligence

As discussed in Section 2.2, diligence is the process by which ACE may be achieved. Kalbers and Fogarty (1993, p.26) define diligence as *“the persistence with which audit committee members apply their desire to carry out their duties”*. Although diligence has multiple facets, most studies in this area focus solely on the number of AC meetings. This is understandable since many of the proxies of diligence are complex to measure and witness in practice (DeZoort et al. 2002). Although there is no set number of meetings and this is left up to the discretion of the chairperson to decide, it is advised to hold at least three meetings per year (FRC 2016). However, the Maltese Listing Rules actually specify that the AC shall meet not less than four times per year (Listing Authority – Malta 2019, S.5.131). In fact, the majority of Maltese ACs meet between five to six times a year however, more ad hoc meetings may be held, especially during an audit cycle (Camilleri 2016, Micallef 2015). It is also imperative that the chairman ensures there is a *“free and open”* debate during such meetings and that they are not taken over by management (FEE 2016, p.12). In fact, Braiotta et al. (2010) states that management should not be present at the AC meetings.

Prior studies have concluded that there are a number of adverse effects to not having regular AC meetings, such as: increased financial reporting problems (McMullen, Raghunandan 1996), increased number of restatements (Abbott, Parker et al. 2004) as well as a greater likelihood of fraud (Beasley, Carcello et al. 1999). More recently, Khlif and Samaha (2016), also argued that an active AC would be able to undertake precautionary actions on time in order to rectify and reduce IC deficiencies.

Raghunandan and Rama (2007) postulate a number of corporate characteristics which influence the number of AC meetings. For instance, businesses performing weakly financially or are significantly leveraged or having steep growth would more likely have frequent meetings. As the number of meetings increases, the oversight function becomes more effective and the financial performance is enhanced (Aldamen, Duncan et al. 2012). All in all, more frequent AC meetings

enhance financial reporting adequacy and external audit quality (DeZoort et al. 2002).

## 2.6 Internal Audit Contribution

IAFs should be set up in organisations to continuously monitor fundamental controls and processes (Cadbury 1992). Hence, the IAF could be fundamental in assisting the AC in carrying out its responsibilities, specifically that of supervising the ICs of the company. The AC can employ the competence and knowledge of the IAF, by combining the capacity of its work, its supplies and priorities (Chartered Institute of Internal Auditors 2015). The Institute of Internal Auditors (IIA) argued that the IAF is the third line of defence, in that;

*“Internal auditors provide the governing body and senior management with comprehensive assurance based on the highest level of independence and objectivity within the organization.” (IIA 2013, p. 5).*

Being the final line of defence, the IAF should be independent from management in order to supervise the remaining two lines of defence ultimately aiding the AC (Roussy, Rodrigue 2016). In fact, the ECIIA and FERMA (2014) also argued that the AC should repeatedly invite the IA to attend its meetings to present the independent assurance. The IAF's reporting lines need to be established clearly, with the different personnel responsible for audit, reporting to the head IA, who in turn should report to the AC chairman (Le Riche 2014). Moreover, a strong relationship between the IAF and the AC is essential, where the AC provides clear targets of focus as well as the required support for the IAF's continuous functioning (Cavaleros 2013).

## 2.7 Assessment

The AC should carry out a regular assessment of its own performance, its plans for future work as well as its communication with both the Board and external auditors. The method of assessment used by the Board and the AC should be

left to their discretion and as such, it is common that they self-evaluate (ACI 2017).

However, due to the greater significance and importance that has been given to the AC, it is questionable whether the AC should conduct only a self-evaluation or whether it should consider assessment from some external stakeholders (FEE 2016). Since all ACs differ depending on the culture and CG of their own organisation, there is no one process of assessment which will fit all ACs. Nonetheless, there are certain recommended guidelines, including that the evaluation procedure should be independent of managerial influence (ACI 2017). Therefore, third-party assessment of the AC should perhaps be given greater consideration.

## **2.8 Conclusion**

This chapter commenced with a description of Maltese ACs, their composition and roles. It then presented certain criteria which aid in making an AC effective. Such literature has laid the foundation for the research in this study. The following chapter shall discuss the research methodology employed to obtain the data for the study.

# RESEARCH METHODOLOGY

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## CHAPTER 3

### **3.1 Introduction**

This chapter outlines the research methodology used in this study. As depicted in Figure 3.1 overleaf, Section 3.2 describes the preliminary secondary research undertaken. Section 3.3 and 3.4 go on to define the research design and research tool used respectively. Section 3.5 then explains how participants were selected and Section 3.6 describes the data collection method. Section 3.7 goes on to describe the data analysis while Section 3.8 discusses the research limitations of the study. Finally, Section 3.9 concludes the chapter.



*Figure 3.1: Outline of Chapter 3*

## 3.2 Secondary Research

At the preliminary phase of the study, information regarding the research topic was gathered from existing literature in order to gain insight into the area and set the objectives of this dissertation. The analysis consisted mainly of books, reports, academic articles and peer-reviewed journals.

Although limited, attention was given to Maltese studies to understand the local scenario. Furthermore, a thorough analysis of EU and Maltese regulatory frameworks governing ACs was conducted for the purpose of analysing AC composition and responsibilities and for proposing recommendations for improvement.

## 3.3 Research Design

Generally speaking, there are three main types of research designs that could be employed: qualitative, quantitative and mixed-methods (Saunders, Lewis et al. 2016). The choice is ultimately influenced by a number of things, namely, the research strategy, the methodology for gathering and analysing data, the researcher's own experiences and most importantly, the study's research questions (Creswell 2014, Saunders et al. 2016).

Qualitative research attempts to study phenomena and social situations by adopting an interpretative and inductive approach whereas quantitative research explains phenomena through numerical data and mathematical analysis (Yilmaz 2013). In this manner, qualitative research may provide a comprehensive understanding of the phenomena or situation. However, it may fall short of allowing the researcher to generalise the findings as quantitative research would allow and vice versa (Creswell 2014).

Therefore, at times, researchers might require a mixed-methods approach in order to overcome the intricacies and different features of the research questions (Plano Clark 2017). Moreover, a mixed-method approach exploits the

advantages of both quantitative and qualitative approaches yielding greater benefits to the researcher while analysing the research topic (Östlund, Kidd et al. 2011). Thus, when neither the exclusive use of qualitative or quantitative methods sufficiently addresses the research objectives, then such an approach is considered to be suitable (Hesse-Biber 2015).

### 3.4 Research Tool

The research instrument most appropriate to achieve the pre-determined objectives of this study is deemed to be the semi-structured interview (SSI). In semi-structured interviewing, an interview schedule is used with standardised questions and probes over which the interviewer has some control. This ensures that all the intended material is covered by the researcher (Harrell, Bradley 2009). Furthermore, interviewees are unrestricted to answer the open-ended questions as they desire and since all participants are asked the same set of questions, the data obtained can be analysed and compared arithmetically (Mcintosh, Morse 2015). Moreover, the unique structure of the SSI allows it to be employed in mixed-method research (ibid.).

The interview schedule<sup>2</sup> developed for this research study consists of seven sections and was targeted at IAs, CFOs and EAs of MLCs as well as the local regulators of ACs. Section A1 of the interview schedule was used to collect information from interviewed MLC representatives on the composition, independence and diligence of their respective ACs. It is to be noted that only eight interviewed internal auditors answered this section. Furthermore, Section A2 of the interview schedule provided some definitions and the Likert scale to be used for the closed-ended questions.

Table 3.1 overleaf depicts the sections of the interview schedule.

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<sup>2</sup> Vide Appendix 3.1

<b>Section Heading</b>		<b>Question Number</b>
<b>Section 1:</b>	Determinants of Audit Committee Effectiveness	1
<b>Section 2:</b>	Composition of the Audit Committee	2 – 9
<b>Section 3:</b>	Authority and Resources of the Audit Committee	10 – 13
<b>Section 4:</b>	Diligence of the Audit Committee	14 – 16
<b>Section 5:</b>	Internal Audit Contribution	17
<b>Section 6:</b>	Assessment of the Audit Committee	18 – 19
<b>Section 7:</b>	Overall Effectiveness of Audit Committees	20
<b>Section A1:</b>	Respondent Characteristics	C1 – C8
<b>Section A2:</b>	Definitions and Likert Scale	-

*Table 3.1: Interview Schedule Structure*

The interview schedule consisted of a combination of both closed-ended and open-ended questions. Table 3.2 overleaf distinguishes between such questions in each section of the interview schedule. Table 3.3 then illustrates the five-point Likert scale used to formulate the closed-ended questions.

Question Type	Section	Question Number
Open-Ended	2	2.B, 5.B – 6.B, 8, 9.B
	3	10 – 13.B
	4	14.A – 14.B, 16.A – 16.C
	5	17.A
	6	19.A – 19.H
	A1	C1
Closed-Ended	1	1
	2	2.A, 3 – 5.A, 7, 9.A
	3	13.C
	4	14.C – 15.B
	5	17.B
	6	18
	7	20
	A1	C2 – C8

*Table 3.2: Combination of Open-Ended and Closed-Ended Questions*

Response	Scale
Strongly Disagree	0
Disagree	1
Neutral	2
Agree	3
Strongly Agree	4

*Table 3.3: Likert Scale*

It is to be noted that for question (13.C) and question (17.B), a Likert scale is used however the response varies from 0 being 'Not Sufficient at All' to 4 being 'Highly Sufficient' and from 0 being 'Highly Ineffective' to 4 being 'Highly Effective' respectively. Moreover, the final question (Qn.20) consists of a scale from 0 to 100 where 0 corresponds to 'Highly Ineffective' and 100 corresponds to 'Highly Effective'.

### 3.5 Research Participants

For the purpose of this study a list of all equity-listed companies on the MSE was obtained from the MSE website. The latest published Annual Reports were examined to identify the heads of internal audit and CFOs. Subsequently, prospective interviewees were contacted via email through email addresses found on the company's website. When no personal email was found on the company website or the heads of internal audit and CFOs were not specifically mentioned in the Annual Report, contact was made through the company's administration email and asked to speak to the head of internal audit and/or the CFO. Attached to the email was a Letter of Introduction and Invitation to Participate in Research which concisely described the study and which was signed by the Head of the Department of Accountancy to strengthen the credibility of the email. If no response was obtained within two weeks, an email reminder was sent and if another two weeks elapsed and yet no response was obtained, another reminder was sent. Unfortunately, some never responded to the emails sent and some others declined to participate in the study.

As shown in Table 3.4 overleaf, a total of sixteen interviews were carried out. Ten interviews were conducted with representatives of MLCs comprising mainly of heads of internal audit (IA) and one CFO (C) and four interviews were carried out with audit firm representatives (EA) from the Big 4 firms. These professionals were chosen as the target population for the research study as they are the main users of ACs and actively participate in AC meetings. Two other interviews were held with the regulators (Regulator) of ACs - an official from the Malta Financial Services Authority (MFSA) and an official from the Accountancy Board since their participation was deemed to aid in better understanding the effectiveness, or lack thereof, of Maltese ACs.

Interviewee Category	Details	Number of Interviewees	Total
Representative of MLCs	Heads of internal audit	9	
	CFO	1	<b>10</b>
Audit firm representatives	Partner	3	
	Audit Director	1	<b>4</b>
AC regulators	MFSA official	1	
	Accountancy Board official	1	<b>2</b>
<b>Total number of interviewees</b>			<b>16</b>

*Table 3.4: Interviewees Participating in Research*

### 3.6 Data Collection

When collecting data, it is essential that the appropriate collection methods are utilised to strengthen the precision, legitimacy and dependability of the research findings (Harrell, Bradley 2009).

For the purpose of this study, secondary data was collected from various sources and thoroughly discussed in Chapter Two of this dissertation. Consequently, this information was used to prepare the interview schedule. A preliminary interview was carried out and feedback was noted to rectify potential issues prior to collecting the data (Snyder 2019). Following this pilot interview, the questions were amended as necessary and the final interview schedule was prepared.

When requested by interviewees, the interview schedule was made available via email before the interview. However, a printed version of the interview schedule was always made available at the beginning of the interview. Interviews were carried out between the 7<sup>th</sup> of November 2019 and the 9<sup>th</sup> of March 2020 at the interviewees' premises on a date and time most suitable for the interviewees. Interviews lasted between forty-five minutes and one hour and 15 minutes. At the outset, interviewees were asked to sign a consent form, getting their explicit consent to be interviewed and audio recorded. Even though it was made clear

that the audio recording would solely be used for transcript purposes to facilitate the data collection process and that none of their replies would be associated with them or their organisation, some interviewees still declined to be recorded. In such cases, additional notes were taken by the researcher during the interview.

### **3.7 Data Analysis**

The audio recordings were transcribed shortly after the interviews themselves in order to improve the quality of the interviews. Such transcripts together with the comments noted during the interviews aided the researcher to better interpret and analyse the data.

#### ***3.7.1 Qualitative Data Analysis***

Qualitative data was obtained through the open-ended questions and also further comments and explanations given to the Likert scale ratings of the closed-ended questions by the interviewees. A question-by-question summary of the transcripts was drawn up and the similarities and discrepancies were highlighted. This facilitated the assessment of such qualitative data.

#### ***3.7.2 Quantitative Data Analysis***

Quantitative data was obtained through the closed-ended questions asked in the interview schedule.

The Friedman Test<sup>3</sup> was used to relate the mean rating scores provided to each statement of the Likert scale questions. This test's main purpose is to assess whether the mean rating scores provided by interviewees to the statements vary significantly or not.

The Mann-Whitney Test<sup>4</sup> was employed to compare the mean rating scores provided by the different groups of interviewees and to identify any disparities

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<sup>3</sup> Vide Appendix 3.2

<sup>4</sup> Vide Appendix 3.3

between their responses. In this case, five statistically significant differences were found which are discussed further in Chapter Four<sup>5</sup>. In all other cases, the results of this test found that the mean rating scores given to the statements do not differ significantly between different categories of interviewees.

Furthermore, the Spearman Test<sup>6</sup> was used to analyse the strength of the relationship between selected questions and the last question of the interview schedule. In this case, one statistically significant difference was found, and this is discussed further in Chapter Five<sup>7</sup>. In all other cases, the results of the Spearman Test are not statistically significant.

### **3.8 Research Limitations**

Despite the various efforts, a small number of IAs and CFOs who were originally targeted refused to participate or failed to reply. Therefore, although the responses of actual respondents in most aspects of the interview were indicative of saturation of discussion, the views of such non-participants may have also provided a further contribution to the study. Moreover, the interviewee responses themselves held an inevitable element of subjectivity. Additionally, some discrepancies were noted between ratings and explanations given to Likert scale questions and other qualitative interview questions.

Furthermore, beyond the IAs, CFOs, EAs and Regulators whose opinions were sought, there are other parties who are or may be involved in ACs. These include risk managers or AC members themselves. Such additional parties were excluded for practical purposes from the methodology of this study.

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<sup>5</sup> Vide Section 4.3.1, Section 4.3.6, Section 4.4.4, Section 4.5.2

<sup>6</sup> Vide Appendix 3.4

<sup>7</sup> Vide Section 5.7

### **3.9 Conclusion**

This chapter described and explained the research methodology used in this dissertation. The following chapter presents the research findings collected by means of the interviews.

# RESEARCH FINDINGS

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## CHAPTER 4

## **4.1 Introduction**

This chapter presents an analysis of the findings gathered from the semi-structured interviews in the order of the eight sections of the interview schedule. As outlined in Figure 4.1 overleaf, Section 4.2 is about the determinants of ACE, Section 4.3 focuses on the composition, Section 4.4 is on authority and resources, Section 4.5 deals with diligence, Section 4.6 internal audit contribution, Section 4.7 reports on assessment and Section 4.8 addresses the overall effectiveness of audit committees. Finally, Section 4.9 concludes the chapter.

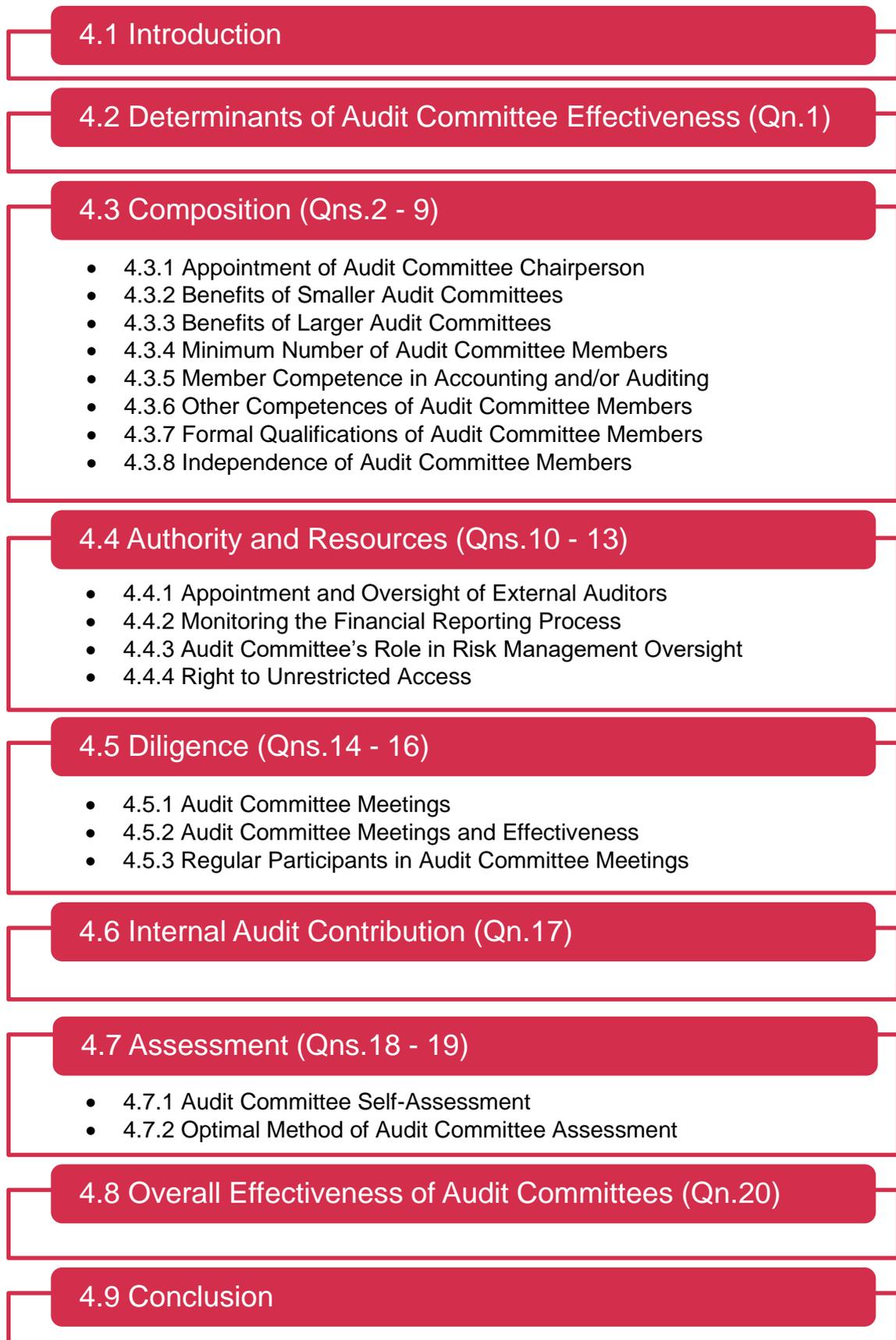


Figure 4.1: Outline of Chapter 4

## 4.2 Determinants of Audit Committee Effectiveness (Qn.1)

The preliminary part of the interview schedule consisted of one question regarding the determinants of audit committee effectiveness (ACE). Interviewees were asked<sup>8</sup> to rate their agreement with six determinants extracted from the literature<sup>9</sup> upon which factors the AC degree of effectiveness may depend. Table 4.1 below provides the mean rating scores of the results in descending order. As may be seen, there were significant differences in the level of agreement ( $p=0.000$ ).

The degree of effectiveness of an AC depends primarily on its:	Number of interviewees = 16		
	Mean	Median	St. Dev
v. Availability of internal audit	3.88	4	0.342
i. Composition	3.69	4	0.479
iv. Diligence	3.63	4	0.619
ii. Authority	3.56	4	0.629
vi. Assessment	3.13	3	1.025
iii. Resources (ex. budget)	2.88	3	1.025
Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)	$X^2(5) = 22.313, p = 0.000$		

Table 4.1: Primary Components of ACE (Qn.1)

### ***The Availability of Internal Audit***

Respondents clearly considered the availability of an IAF as being the highest determinant and in fact strongly agreed ( $\bar{x}=3.88$ ) that this primarily impacts the ACE. Nonetheless, although also agreeing to such availability, one Regulator<sup>(1/16)</sup> cautioned that even with this, the AC is not rendered “bulletproof”.

<sup>8</sup> Vide Q.1 p.A3.1-2

<sup>9</sup> Vide Section 2.2

### ***The Composition of ACs***

Interviewees strongly agreed ( $\bar{x}=3.69$ ) that the composition of ACs is another determinant. Two IAs (*internal auditors*)<sub>(2/16)</sub> clarified that nowadays it is essential to have members who are competent in finance and, even more importantly in IT so that adequate importance is placed on cyber-security.

### ***The Diligence of ACs***

Interviewees strongly agreed ( $\bar{x}=3.63$ ) that diligence also impacts ACE. Although agreeing, one IA<sub>(1/16)</sub> added that ACs cannot be diligent if they lack the trust of their Board and management. Conversely, one Regulator<sub>(1/16)</sub> was neutral on this, explaining that effectiveness depends more on “*asking the right questions*” than diligence.

### ***The Authority of ACs***

Interviewees strongly agreed ( $\bar{x}=3.56$ ) that the authority of ACs impacts their effectiveness. Although also agreeing to this, one IA<sub>(1/16)</sub> clarified that such authority is one derived from the Board and while such authority is “*not executive*”, ACs still cannot allow themselves to be a mere “*rubber stamp*”. One Regulator<sub>(1/16)</sub> was neutral about this because in his/her view, more authority to the AC could easily “*counterfire*” by having the AC dominated by any one member. S/he explained that, the emphasis, rather than being on authority needs to be on the objectivity of members if an AC is to be effective.

### ***The Assessment of ACs***

Respondents agreed ( $\bar{x}=3.13$ ) that ACs are to carry out regular assessments of their performance. Such assessments are to include how far ACs have managed to keep their Boards informed of their workings as well as how far they reached their objectives in the previous year. Seven respondents<sub>(7/16)</sub> noted that third parties are to be involved in carrying out such assessments.

### **The Resources of ACs**

Regarding resources, respondents agreed ( $\bar{x}=2.88$ ) that these impact ACE. However, one IA<sub>(1/16)</sub> strongly disagreed, arguing that ACs “*don’t even need a budget*”.

## **4.3 Composition (Qns.2 – 9)**

The second part of the interview schedule, consisted of eight questions (Qns.2 – 9) focussing on AC composition.

### **4.3.1 Appointment of Audit Committee Chairperson**

Respondents were provided with three statements<sup>10</sup> on how an AC chairperson needs to be appointed and asked to rate their agreement with each one. Table 4.2 below lists the mean rating scores. As may be seen, there were significant differences in the level of agreement ( $p=0.037$ ).

An AC chairperson needs to be:	Number of interviewees = 16		
	Mean	Median	St. Dev
i. Appointed by the Board	3.31	3	0.704
ii. Recommended by the AC itself and officially appointed by the Board	2.31	2	1.138
iii. Nominated by the nomination committee and officially appointed by the Board	2.31	2	1.014
Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)	$X^2(2) = 6.582, p = 0.037$		

Table 4.2: Process of Appointing an AC Chairperson (Qn.2.A)

### **Does an AC Chairperson need to be Appointed by the Board?**

Interviewees agreed ( $\bar{x}=3.31$ ) that an AC chairperson needs to be appointed by the Board. Two IAS<sub>(2/16)</sub> explained that the vetting to become a director in an MLC is

<sup>10</sup> Vide Q2.A p.A3.1-3

ever increasing, thus the Board undoubtedly has the capacity and experience to appoint an appropriate AC chairperson. One IA<sub>(1/16)</sub> suggested that the Board needs to determine the AC composition yet still allow the AC members to appoint their chairperson.

***Does an AC Chairperson need to be Recommended by the AC and Officially Appointed by the Board?***

Respondents were controversial ( $\bar{x}=2.31$ ) regarding this matter. While strongly agreeing or agreeing, seven respondents<sub>(7/16)</sub> argued that AC members need to have a say in the decision. However, slightly more interviewees<sub>(9/16)</sub> disagreed, stating as Board sub-committees, that ACs are not to be self-governing and therefore such a decision needs to be a matter for the whole Board.

***Does an AC Chairperson need to be Nominated by the Nomination Committee and Officially Appointed by the Board?***

Interviewees were controversial ( $\bar{x}=2.31$ ) on this matter as well. Seven<sub>(7/16)</sub> agreed or strongly agreed to this, despite that up to now many MLCs do not as yet have a Nomination Committee. However, marginally more respondents<sub>(9/16)</sub> were neutral or disagreed, stating that ultimately the Board needs to decide this. Interestingly, EAs/Regulators agreed significantly more ( $p=0.037$ ) than MLC representatives<sup>11</sup>.

Interviewees were then asked<sup>12</sup> for their view on common practices in Malta with respect to the appointment of the AC chairperson. Interviewees<sub>(16/16)</sub> clarified that in Malta it is the Board which commonly appoints the AC chairperson. Two EAs<sub>(2/16)</sub> argued that the Board usually appoints the NED who is competent in accounting/auditing as the AC chairperson. This is in line with Collier (1993)<sup>13</sup>. One IA<sub>(1/16)</sub> qualified this, stating that this depends on whether such a person is independent besides being competent.

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<sup>11</sup> Vide Mann-Whitney Test 1 Statement (iii) in Appendix 3.3

<sup>12</sup> Vide Q2.B p.A3.1-3

<sup>13</sup> Vide Section 2.3.1

### 4.3.2 Benefits of Smaller Audit Committees

It is to be noted that, an analysis of the responses by eight IAs in the Respondent Characteristics Section of the interview schedule indicated that the average number of members in their company's ACs is three and that they are mostly male<sup>14</sup>. Given such information, ascertaining the benefits of smaller ACs is clearly relevant.

In this connection, interviewees were presented with four statements<sup>15</sup> concerning benefits of smaller ACs and asked to rate their agreement. Table 4.3 below presents the mean rating scores.

The following are likely to be the benefits of having an AC limited to the statutory minimum number of members (i.e. 3):	Number of interviewees = 16		
	Mean	Median	St. Dev
iii. Efficient use of time	2.63	3	0.885
iv. More unanimity	2.38	2	0.957
i. Fewer process inefficiencies	2.31	2.5	0.793
ii. Fewer differences	2.00	2	0.894
Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)	$X^2(3) = 5.138, p = 0.162$		

Table 4.3: Advantages of Smaller ACs (Qn.3)

#### **Statutorily Smaller ACs – Increased Efficiency?**

Interviewees marginally agreed ( $\bar{x}=2.63$ ) that having ACs statutorily limited in number is likely to be beneficial with respect to efficiency. Three (3/16) added that this is because it is “easier to coordinate” and “to set meetings” with three members. However, others were neutral (4/16) or disagreed (2/16), arguing that “ultimately it boils down to the individuals”.

<sup>14</sup> Vide Q.C2 & Q.C3 p.A3.1-13

<sup>15</sup> Vide Q3 p.A3.1-4

***Statutorily Smaller ACs – More Unanimity?***

Respondents were neutral ( $\bar{x}=2.38$ ) to this statement arguing that, although unanimity might increase with smaller ACs, this is not necessarily an advantage.

***Statutorily Smaller ACs – Fewer Process Inefficiencies?***

Respondents were neutral ( $\bar{x}=2.31$ ) on whether smaller ACs have fewer process inefficiencies. Interviewees (16/16) stated that although technically a smaller number of members creates fewer process inefficiencies, this mainly depends on the members' competencies. One EA (1/16) argued that AC size needs to depend on the "company's exigencies" rather than to limit inefficiencies.

***Statutorily Smaller ACs – Fewer Differences?***

Respondents were undecided ( $\bar{x}=2.00$ ) regarding this matter. Most (14/16) added that, with fewer people, one indeed normally expects to have fewer differences, but this is not necessarily beneficial as differences may promote different perspectives and healthy discussions.

***4.3.3 Benefits of Larger Audit Committees***

Respondents were then presented with three statements<sup>16</sup> regarding the benefits of larger ACs and asked to rate their agreement. Table 4.4 overleaf presents the mean rating scores. As may be seen, there were significant differences in the responses ( $p=0.000$ ).

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<sup>16</sup> Vide Q4 p.A3.1-4

The following are likely to be the benefits of larger ACs (i.e. having more than 3 members): <u>An oversight function...</u>	Number of interviewees = 16		
	Mean	Median	St. Dev
i. with a wider degree of expertise and skills	3.38	3	0.500
iii. which enhances more widely the overall oversight	3.00	3	1.033
ii. which enhances more deeply financial performance	1.88	2	0.957
Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)	$\chi^2(2) = 23.106, p = 0.000$		

Table 4.4: Advantages of Larger ACs (Qn.4)

### ***Larger ACs – An Oversight Function with a Wider Degree of Expertise and Skills?***

Interviewees agreed ( $\bar{x}=3.38$ ) that more members would likely increase AC skillsets. One agreeing IA<sub>(1/16)</sub> explained that more members increase the mix of ideas and questions, enhancing discussions. However, another IA<sub>(1/16)</sub> mentioned that, beyond five members, additional members contribute to no added value.

### ***Larger ACs – An Oversight Function which Enhances more Widely the Overall Oversight?***

Interviewees agreed ( $\bar{x}=3.00$ ) that larger ACs may enhance the oversight function. However, one IA<sub>(1/16)</sub> clarified that this also depends on the members' available time to delve into certain matters. One disagreeing EA<sub>(1/16)</sub> stated that this depends on the expertise of members not their number.

### ***Larger ACs – An Oversight Function which Enhances more Deeply Financial Performance?***

Respondents were undecided ( $\bar{x}=1.88$ ) as to whether larger ACs enhance financial performance. Those in disagreement<sub>(5/16)</sub> added that this depends on member competencies rather than AC size. One EA<sub>(1/5)</sub> emphasised that Boards need to focus on enhancing the financial performance itself, not ACs.

#### 4.3.4 Minimum Number of Audit Committee Members

Interviewees were then asked<sup>17</sup> to rate their agreement as to whether the degree of ACE is influenced by the size of the AC. Table 4.5 below provides the mean rating score.

	Number of interviewees = 16		
	Mean	Median	St. Dev
The degree of effectiveness of an AC is influenced by the size of the AC.	2.31	2	0.793
Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)			

Table 4.5: Size Influences the Degree of ACE (Qn.5.A)

As may be seen, interviewees were neutral ( $\bar{x}=2.31$ ) on this. One Regulator<sub>(1/16)</sub>, upon agreeing, added that if ACs become too large, there is a danger that meetings would easily be “paralysed”.

Interviewees were then asked<sup>18</sup> whether they think that the minimum number of three members stipulated by Maltese law is appropriate. Most<sub>(13/16)</sub> agreed to this. Two IAs<sub>(2/13)</sub> added that “three suffice, more is a crowd, only amplifying the challenges of reaching a consensus”. Two interviewees<sub>(2/16)</sub> argued that such minimum varies with the needs of the MLC. One Regulator<sub>(1/16)</sub> disagreed with the minimum, arguing that with three a quorum may easily be lost, impacting the number of meetings which ACs could hold.

Interviewees were then asked<sup>19</sup> whether they think that a maximum threshold needs to be established by law. Eleven respondents<sub>(11/16)</sub> disagreed with this, arguing that Boards have the necessary skills to decide what is best for their company depending on the organisation’s complexity and size. Five<sub>(5/16)</sub> agreed

<sup>17</sup> Vide Q5.A p.A3.1-5

<sup>18</sup> Vide Q5.B.i p.A3.1-5

<sup>19</sup> Vide Q5.B.ii p.A3.1-5

to have a maximum set by law setting such maximum as five<sup>(2/5)</sup>, six<sup>(1/5)</sup> or seven<sup>(1/5)</sup> members.

Finally, interviewees were asked<sup>20</sup> what, in their opinion, determines the size of ACs. Table 4.6 below summarises the responses given by interviewees.

<b>AC size is determined by the:</b>	<b>Responses (N = 16)</b>
Complexity of the business and its industry	8
Skillsets of the members	6
Size of the company	5
Structure of shareholding	2
Responsibilities entrusted upon the AC	1
<b><i>Total number of responses</i></b>	<b>22*</b>

\*Some respondents gave more than one size determinant.

*Table 4.6: Determinants of AC Size (Qn.5.B.iii)*

As may be seen, the most quoted<sup>(8/22)</sup> determinant was that of business and industry complexity on the basis that if companies operate in highly regulated industries, they are likely to require bigger ACs to ensure they encompass the necessary competencies. The determinant next quoted was member skillsets<sup>(6/22)</sup> on the basis that one may or may not find the required skillsets in a few members. Another more quoted determinant was the size of the MLC<sup>(5/16)</sup> because, as in many other matters, AC size tends to be proportional to the company's size.

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<sup>20</sup> Vide Q5.B.iii p.A3.1-5

### 4.3.5 Member Competence in Accounting and/or Auditing

It is to be noted that an analysis of the responses by eight IAs in the Respondent Characteristics Section of the interview schedule indicated that most members in their own company's ACs are qualified either in accounting/auditing or in information technology (IT)<sup>21</sup>.

In this context, respondents were first asked<sup>22</sup> what they consider to be a sufficient level of competence in accounting and/or auditing. Table 4.7 below summarises interviewee responses.

<b>A sufficient level of accounting/auditing competence entails:</b>	<b>Responses (N = 16)</b>
Being a certified public accountant (CPA)	12
Having sufficient experience in accounting/auditing	11
Having kept abreast with developments in the field	3
Having expertise in finance	3
<b>Total number of responses</b>	<b>29*</b>

\*Some respondents gave more than one level of competence.

*Table 4.7: Sufficient Level of Accounting/Auditing Competence (Qn.6.A)*

As may be seen, twelve comments<sub>(12/29)</sub> referred to the requirement that the member at least needs to be a CPA. Moreover, other comments<sub>(11/29)</sub> referred to a minimum requirement of ten years' experience in the field of accounting/auditing, preferably in the company's same industry. Three comments<sub>(3/29)</sub> also referred to the need for members to keep abreast of current developments in the industry.

Secondly, interviewees were asked<sup>23</sup> whether they believe that having accounting/auditing expertise is essential for the proper functioning of ACs.

<sup>21</sup> Vide Q.C4 p.A3.1-13

<sup>22</sup> Vide Q6.A p.A3.1-5

<sup>23</sup> Vide Q6.B p.A3.1-5

Interviewees<sub>(16/16)</sub> agreed, with six<sub>(6/16)</sub> arguing, in line with BRC (1999)<sup>24</sup>, that financial statements have become so complex that such expertise is a *sine qua non*. Furthermore, four<sub>(4/16)</sub> added that such competence does not have to be held by the chairperson.

#### 4.3.6 Other Competencies of Audit Committee Members

Respondents were provided with four statements<sup>25</sup> concerning the AC members' required and actual competencies and asked to rate their agreement. Table 4.8 below provides the mean rating scores.

	Number of interviewees = 16		
	Mean	Median	St. Dev
A.1. The more diversity of skills, background and experiences of the members of the AC, the better is such an AC.	3.63	4	0.500
A.2. To my knowledge, most ACs in Malta actually have sufficient diversity of skills, background and experiences.	2.19	2	0.834
B.1. In addition to A.1, in order to competent, the AC needs to have the majority of members competent in the specific sector in which their company is operating.	2.31	2	0.873
B.2. To my knowledge, the majority of members in Maltese ACs are actually competent in the specific sector in which their company is operating.	2.06	2	0.998
Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)	$\chi^2_A(1) = 14.000, p_A = 0.000$ $\chi^2_B(1) = 0.667, p_B = 0.414$		

Table 4.8: Required and Actual Competencies of AC Members (Qn.7)

As may be seen, the four statements were presented in two parts. In the first part, two statements (A.1 and A.2) were presented on the required and actual diversity

<sup>24</sup> Vide Section 2.3.3

<sup>25</sup> Vide Q7 p.A3.1-6

of skills, background and experiences of AC members while, in the second part, two other statements (B.1 and B.2) were presented on the required and actual competencies of AC members in the specific sector in which the company is operating. As may be seen, in the first part there were significant differences in the responses between the required and actual competencies of AC members ( $p=0.000$ ).

***Is an AC Better the more Diversity of Skills, Background and Experiences of its Members?***

Interviewees strongly agreed ( $\bar{x}=3.63$ ) that the more diversity of skills, background and experiences of the AC members, the better is such an AC. One IA<sub>(1/16)</sub> mentioned that this also increases members' independence since their competence prevents them from being dissuaded in certain instances.

***But do ACs in MLCs Actually have Sufficient Diversity of Skills, Background and Experiences?***

Respondents were neutral ( $\bar{x}=2.19$ ) on whether MLC ACs actually have sufficient skills, background and experiences. Furthermore in this connection, MLC representatives agreed to this significantly more ( $p=0.046$ ) than the EAs/Regulators<sup>26</sup>. Two EAs<sub>(2/16)</sub> explained that, although ACs have improved, more diversity of skills is required. Additionally, one Regulator<sub>(1/16)</sub> argued that this varies in the different sectors.

***Are the Majority of AC Members to be Competent in their Company's Specific Sector?***

Respondents were neutral ( $\bar{x}=2.31$ ) regarding this statement. Eleven<sub>(11/16)</sub> argued that other competencies are important and thus there is no need for the majority to hold sector competence. This is in line with ECODA and PwC (2016)<sup>27</sup>. One EA<sub>(1/16)</sub> argued that this is essential, explaining that otherwise effective contribution would not be possible.

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<sup>26</sup> Vide Mann-Whitney Test 2 Statement A.2 in Appendix 3.3

<sup>27</sup> Vide Section 2.3.3

***But are the Majority of AC Members within MLCs Actually Competent in their Company's Specific Sector?***

Interviewees were undecided ( $\bar{x}=2.06$ ) whether the majority of AC members within MLCs are actually competent in their company's sector. Seven (7/16) explained that only some members are competent in the sector. One EA (1/16) agreed that the majority are competent in the sector but to different degrees.

***4.3.7 Formal Qualifications of Audit Committee Members***

Interviewees were asked<sup>28</sup> for their view as to what other formal qualifications, if any, do AC members, or at least some of them, need to have. Table 4.9 below summarises the main responses given.

<b>The formal qualifications of AC members are required to be related to:</b>	<b>Responses (N = 16)</b>
The company's industry	8
Law/regulations/compliance	8
IT	7
Risk management	3
Business management	3
Economics and statistics	2
<b><i>Total number of responses</i></b>	<b><i>31*</i></b>

\*Some respondents gave more than one formal qualification.

*Table 4.9: The Required Formal Qualifications of AC Members (Qn.8)*

The most common (8/31) response given was that qualifications are to be related to the company's industry. The next common response (8/31) was that qualifications are to be related to law, regulation and compliance with some respondents adding that this is particularly so if the company is a regulated one. Further response (7/31) referred to the need for IT acumen and this tallied with the responses given in the Respondent Characteristics Section of the interview

<sup>28</sup> Vide Q8 p.A3.1-7

section already referred to earlier<sup>29</sup>. Other responses<sub>(8/31)</sub> related to risk and business management and to economics and statistics.

### 4.3.8 Independence of Audit Committee Members

It is to be noted that an analysis of the responses by eight IAs in the Respondent Characteristics Section of the interview schedule indicated that most members in their company's ACs are actually INEDs<sup>30</sup>. Given this, ascertaining whether from all the respondents' perspective AC members' independence influences ACE is clearly relevant.

In this connection, interviewees were asked<sup>31</sup> to rate their agreement as to whether ACE is influenced by the degree of AC members' independence. Table 4.10 below provides the mean rating score.

	Number of interviewees = 16		
	Mean	Median	St. Dev
The degree of effectiveness of an AC is influenced by the degree of independence of its members.	3.81	4	0.403
<i>Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)</i>			

*Table 4.10: Degree of Member Independence Influences ACE? (Qn.9.A)*

As may be seen, respondents strongly agreed ( $\bar{x}=3.81$ ) to this statement. Three<sub>(3/16)</sub> argued that this is imperative, as nothing is achieved if they are or even seen to be as "management's puppets". However, one IA<sub>(1/16)</sub> argued that it is challenging to find independent members in Malta owing to both the country's small size and the limited pool of qualified people.

<sup>29</sup> Vide Section 4.3.5

<sup>30</sup> Vide Q.C5 p.A3.1-14

<sup>31</sup> Vide Q9.A p.A3.1-7

A further question asked respondents<sup>32</sup> whether the Listing Rule requirement that the majority of AC members are to be independent is appropriate. Respondents<sub>(16/16)</sub> agreed with this requirement, with two interviewees<sub>(2/16)</sub> adding that this was essential if AC members are to have a clear mindset to challenge management. Two interviewees<sub>(2/16)</sub> specified that they have their reservations as the requirement can only deal with independence in appearance and not with effective independence which remains a question of a “*frame of mind*”.

Interviewees were then provided with two statements<sup>33</sup> and asked whether the stated independence requirement is sufficiently being complied with if the conditions in each of those statements applied. The first part questioned whether AC members are sufficiently independent, if they are not in any way involved in management or directly or indirectly related to the company and its stakeholders. Interviewees<sub>(16/16)</sub> agreed that, given such conditions, the independence requirement would be sufficiently complied with, with two IAs<sub>(2/16)</sub> adding the proviso that any AC member relationship with the company as a customer needs to remain at arm’s length. The second statement questioned whether such AC members would be sufficiently independent if they had in the past been related in any way as described in the first statement yet an adequate cooling-off period had since elapsed. Nine respondents<sub>(9/16)</sub> also agreed that, if such adequate period had elapsed, AC members would again be independent. However, five<sub>(5/16)</sub> added that, by an “adequate” cooling-off period, they meant a specific period which they defined differently from two and twenty years. On the contrary, others<sub>(2/16)</sub> emphasised that such time period had to be determined on a case-by-case basis, the latter being in line with FEE (2016)<sup>34</sup>.

The next question<sup>35</sup> inquired whether it would be an enhancement to AC member independence if, in addition to the current practices as per the previous two statements, AC members have to declare that they are not, nor will they be,

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<sup>32</sup> Vide Q.9.B.i p.A3.1-7

<sup>33</sup> Vide Q.9.B.ii p.A3.1-7

<sup>34</sup> Vide Section 2.3.4

<sup>35</sup> Vide Q9.B.iii p.A3.1-7

controlled or otherwise unduly influenced by any other non-member. Twelve interviewees<sub>(12/16)</sub> stated that the requirement for such a declaration would be an enhancement. One<sub>(1/12)</sub> added that such a declaration of independence is perhaps the only formal procedure which is needed in this regard and this might serve useful if AC members do breach their independence. However, four respondents<sub>(4/16)</sub> claimed that such a declaration does not in itself add any comfort to shareholders.

#### **4.4 Authority and Resources (Qns.10 – 13)**

The third section of the interview schedule consisted of four questions (Qns.10 – 13) focussing on AC authority and resources.

##### **4.4.1 Appointment and Oversight of External Auditors**

Interviewees were asked<sup>36</sup> whether the AC Listing Rule requirement to recommend an EA and oversee their independence has reduced the impact of management association in the process. Interviewees' responses were undecided with half<sub>(8/16)</sub> agreeing that management association has been reduced, although most added that this reduction had not been significant. This is in contrast to Dhaliwal et al. (2015) and Looknanan-Brown's (2011) findings<sup>37</sup> who found no such reduction. Three<sub>(3/8)</sub> added that in view of the tendering process overseen by the AC, management can no longer select the EA behind closed doors. One IA<sub>(1/8)</sub> clarified that in his/her organisation, the EA is chosen by the overseas AC of the parent company, this further reducing management association. However, eight interviewees<sub>(8/16)</sub> disagreed that management association has been reduced. Five<sub>(5/8)</sub> claimed that it would be "naïve" to believe in this reduction as management, especially the CFO, is still consulted and involved in the tender process, especially given the relatively smaller size of the average MLC.

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<sup>36</sup> Vide Q10 p.A3.1-8

<sup>37</sup> Vide Section 2.4.1

#### **4.4.2 Monitoring the Financial Reporting Process**

It is to be noted that an analysis of the responses by eight IAs in the Respondent Characteristics Section of the interview schedule indicated that none of their respective companies have a separate Financial Reporting Committee<sup>38</sup>. Given this, ascertaining from all the respondents' perspective whether it is more effective to have a separate Financial Reporting Committee is clearly relevant. In this context, interviewees were asked<sup>39</sup> whether it is more effective to have such a separate Committee examining all financial reports prior to ACs. Table 4.11 overleaf summarises the arguments against and in favour and neutral about having such a Committee.

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<sup>38</sup> Vide Q.C7 p.A3.1-14

<sup>39</sup> Vide Q11.A p.A3.1-8

<b>Arguments Against</b>	<b>Responses N=16</b>
Having properly structured ACs with financial experts suffices.	4
It is already challenging to set up effective ACs and adding another committee will be too cumbersome and may overlap with the respective AC.	5
As long as ACs are given the financial reports sufficiently in advance to be able to analyse and ask management questions, there is no such need.	2
<b>Arguments in Favour</b>	
ACs will end up overloaded and fail to meet their objectives	1
Adds to the robustness of the financial reporting process	1
<b>It depends on the...</b>	
resources of the company	2
size of the company	1

*Table 4.11: Is a Separate Financial Reporting Committee Needed? (Qn.11.A)*

Eleven interviewees<sub>(11/16)</sub> argued against having a separate Financial Reporting Committee. Most commonly, respondents indicated that having properly structured ACs with more members competent in accounting/auditing<sub>(4/11)</sub> would eliminate any need for such a Committee. Moreover, another subscribed opinion was that the introduction of another committee would be too cumbersome<sub>(5/11)</sub> for many companies and might overlap with the respective AC. Two<sub>(2/11)</sub> contended that as long as ACs are given reports well in advance of meetings to have time to raise their questions then there will be no such need. This is in line with Braiotta et al. (2010)<sup>40</sup>. Three respondents<sub>(3/16)</sub> stated that this depends on the company's resources and size. Contrastingly, another two<sub>(2/16)</sub> agreed that such a separate Committee is needed as such a Committee adds to the robustness of the financial

<sup>40</sup> Vide Section 2.4.2

reporting process and ACs too often end up “*overloaded*”, with very long meetings that fail to meet their objectives.

Furthermore, interviewees were asked<sup>41</sup> whether such separate Financial Reporting Committees are actually common in Malta. Respondents<sup>(16/16)</sup> stated that in their experience, such committees are not a common feature.

#### ***4.4.3 Audit Committee’s Role in Risk Management Oversight***

It is to be noted that an analysis of the responses by eight IAs in the Respondent Characteristics Section of the interview schedule indicated that most of their respective companies have a separate Risk Management Committee<sup>42</sup>. Given this, ascertaining from all the respondents’ perspective whether it is more effective to have a joint Audit and Risk Committee is clearly relevant.

In this regard, interviewees were asked<sup>43</sup> whether, in their opinion, ACs should also carry out risk management oversight, even though several MLCs are developing a separate risk management oversight function. Table 4.12 overleaf summarises the main arguments as in favour, against and neutral relating to such additional oversight.

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<sup>41</sup> Vide Q11.B p.A3.1-8

<sup>42</sup> Vide Q.C8 p.A3.1-14

<sup>43</sup> Vide Q12.A p.A3.1-8

Arguments in Favour	Responses
The IA and risk manager liaise very closely together.	4
Having joint oversight reduces the risk of duplication and/or of overlooking certain issues.	2
Arguments Against	
Keeping separate oversight ensures that each function focuses on the right issues.	3
RM is becoming more complex and requires a separate function focussing solely on risk issues.	2
It depends on the...	
skillset of AC members	2
industry and complexity of the company	2
competences of the RM unit	1

Table 4.12: Arguments Relating to ACs Conducting Risk Oversight (Qn.12.A)

Six interviewees<sup>(6/16)</sup> agreed that it would be more effective if ACs also carry out risk management oversight. Four<sup>(4/6)</sup> explained that the IAF and risk function work closely together and reporting to the same committee will enable them to “*share ideas and concerns*” easily. Two<sup>(2/6)</sup> stated that having an Audit and Risk Committee would reduce the risk of duplication or of overlooking important issues. However, five interviewees<sup>(5/16)</sup> opposed the idea of having one joint committee. Three<sup>(3/5)</sup> emphasised that under the Enterprise Risk Management Framework, “*risk forms part of the 2<sup>nd</sup> line of defence, while audit part of the 3<sup>rd</sup>*”<sup>(1/2)</sup>. Two<sup>(2/5)</sup> remarked that risk requirements have increased drastically, and therefore, it is essential to have a specific RM committee. Five interviewees<sup>(5/16)</sup> argued that whether the two fall under one committee or not depends on three factors: the AC members’ competencies in risk<sup>(2/5)</sup>, whether the industry is regulated or not<sup>(2/5)</sup> and on the competences of the RM unit<sup>(1/5)</sup>.

Furthermore, respondents were asked<sup>44</sup> whether, in their experience, such joint oversight of the AC is a common feature in MLCs. While three respondents<sup>(3/16)</sup> preferred not to reply, seven<sup>(7/16)</sup> held that this is not common and that usually there are two separate committees. Contrastingly, six interviewees<sup>(6/16)</sup> argued that such additional AC oversight exists in small and probably non-listed companies. This is in line with Beasley, Branson et al. (2019)<sup>45</sup>.

#### **4.4.4 Right to Unrestricted Access**

Interviewees were then asked<sup>46</sup> whether, in their view, it is invariably beneficial to grant ACs unrestricted access to any information, staff and management. Respondents<sup>(16/16)</sup> agreed that such access is beneficial, which is in line with FRC (2016). Two<sup>(2/16)</sup> qualified their response, adding that caution must be exercised so that such unrestricted access would not be abused.

Interviewees were also asked<sup>47</sup> whether they would extend such access towards allowing ACs to engage inhouse and/or external professional advisors. Interviewees<sup>(16/16)</sup> agreed to both possibilities. With regards to external professionals two<sup>(2/16)</sup> highlighted the importance that people of repute are employed to ensure confidentiality.

Furthermore, interviewees were asked<sup>48</sup> to rate, whether in their experience, ACs in MLCs generally have sufficient resources to ensure their effectiveness. Table 4.13 overleaf provides the mean rating score.

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<sup>44</sup> Vide Q12.B p.A3.1-8

<sup>45</sup> Vide Section 2.4.3

<sup>46</sup> Vide Q13.A p.A3.1-8

<sup>47</sup> Vide Q13.B p.A3.1-8

<sup>48</sup> Vide Q13.C p.A3.1-9

	Number of interviewees = 16		
	Mean	Median	St. Dev
In your view are the resources of ACs in MLCs generally sufficient to ensure their effectiveness?	2.94	3	0.854
<i>Scale from 0 (Not Sufficient at All) to 4 (Highly Sufficient)</i>			

*Table 4.13: Adequateness of Resources in MLC ACs (Qn.13.C)*

Interviewees agreed ( $\bar{x}=2.94$ ) that generally AC resources are sufficient, with five (5/16) adding that there still remains room for improvement. Six (6/16) were neutral, stating that this depends on whether or not there is an IAF present in the company. Notably, MLC representatives agreed to this significantly more ( $p=0.025$ ) than the EAs/Regulators<sup>49</sup>.

## 4.5 Diligence (Qns.14 – 16)

The fourth section of the interview schedule consisted of three questions (Qns.14 – 16) focussing on the diligence of ACs. In this connection, it is to be noted that an analysis of the responses by eight IAs in the Respondent Characteristics Section of the interview schedule indicated that the ACs in their own company meet more than four times a year, with an average of seven meetings per year<sup>50</sup>. These three questions relating to the frequency and regularity of meetings may provide further insights on the MLC situation.

### 4.5.1 Audit Committee Meetings

Interviewees were asked<sup>51</sup> whether, in their opinion, it is appropriate for the law to stipulate a minimum number of AC meetings. Most (15/16) agreed, stating this ensures effectiveness. Four (4/15) insisted that it is imperative that companies do not interpret this to meet four times only. One respondent (1/16) disagreed with a

<sup>49</sup> Vide Mann-Whitney Test 3 in Appendix 3.3

<sup>50</sup> Vide Q.C6 p.A3.1-14

<sup>51</sup> Vide Q14.A p.A3.1-9

minimum being set by law, arguing that it would be wiser to set a period which cannot elapse without holding an AC meeting. S/he emphasised that mandating a minimum of four meetings may result in companies “*meeting four times in December*”.

Subsequently, those who agreed to a minimum being mandated were asked<sup>52</sup> whether four is appropriate. Ten respondents<sub>(10/15)</sub> agreed that once quarterly is normally enough but this varies with different companies. Five<sub>(5/15)</sub> explained that a minimum of six meetings would be better, as this would ensure ACs meet at least bimonthly to keep abreast of the organisation’s developments.

Respondents were then asked<sup>53</sup> to rate their agreement with whether the meetings held, on average, by ACs in MLCs are sufficient to achieve their objectives. Table 4.14 below presents the mean rating score.

	Number of interviewees = 16		
	Mean	Median	St. Dev
The number of meetings typically held by ACs in MLCs are sufficient for them to achieve their objectives.	3.00	3	0.632
<i>Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)</i>			

*Table 4.14: Are AC Meetings in MLCs Sufficient? (Qn.14.C)*

Respondents agreed ( $\bar{x}=3.00$ ) that the number of meetings typically held by ACs in MLCs are sufficient. One agreeing EA<sub>(1/16)</sub> remarked that some ACs hold more than four meetings when the need arises. Conversely, three interviewees<sub>(3/16)</sub> were neutral to such statement and claimed that several ACs meet simply to adhere to the Listing Rule requirement relating to frequency of meetings and that this is more common if the IAF is in its initial years.

<sup>52</sup> Vide Q14.B p.A3.1-9

<sup>53</sup> Vide Q14.C p.A3.1-9

### 4.5.2 Audit Committee Meetings and Effectiveness

Interviewees were provided with four statements<sup>54</sup> and asked to rate their agreement with each statement. Table 4.15 below provides the mean rating scores.

	Number of interviewees = 16		
	Mean	Median	St. Dev.
A. The degree of effectiveness of an AC is influenced by the frequency of the AC meetings.	2.94	3	0.772
<b>B. Problems which could arise from not having regular AC meetings include:</b>			
i. Unsolved financial reporting issues	3.06	3	0.929
ii. Increased number of restatements	2.69	2	1.014
iii. Greater likelihood of fraud	2.31	2	0.873
Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)	$\chi^2_B(3) = 6.821, p_B = 0.078$		

Table 4.15: AC Meetings and Effectiveness (Qn. 15)

#### Does the Frequency of AC Meetings Influence ACE?

As may be seen, respondents agreed ( $\bar{x}=2.94$ ) with the first statement that the degree of ACE is influenced by AC meeting frequency. Furthermore, MLC representatives agreed to this significantly more ( $p=0.015$ ) than EAs/Regulators<sup>55</sup>. One IA<sub>(1/16)</sub> upon agreeing, added that meeting frequently is essential to keep in touch with and add value to the organisation. Conversely, five respondents<sub>(5/16)</sub> were neutral, arguing that it is the quality of meetings that impacts ACE and the frequency is to depend on the organisation's needs. This is in contrast with Aldamen et al. (2012) and DeZoort et al. (2002)<sup>56</sup>.

<sup>54</sup> Vide Q15 p.A3.1-10

<sup>55</sup> Vide Mann-Whitney Test 4 Statement (A) in Appendix 3.3

<sup>56</sup> Vide Section 2.5

### ***May Irregular AC Meetings Lead to Unsolved Financial Reporting Issues?***

Interviewees agreed ( $\bar{x}=3.06$ ) that irregular AC meetings may lead to unsolved financial reporting issues as ACs may not deter management from ignoring such problems. Three interviewees (3/16) were neutral and one (1/16) disagreed, arguing that *“financial reporting issues are to be solved by management”*.

### ***May Irregular AC Meetings Lead to Increased Number of Restatements?***

Respondents agreed ( $\bar{x}=2.69$ ) that the number of restatements may increase owing to irregular AC meetings. Seven (7/16) agreed, arguing that having AC regular oversight is imperative for users to have *“proper financial information”*. Conversely, eight respondents (8/16) were neutral, arguing that restatements depend on *“the financial reporting system”* and not on AC oversight. This is in contrast with Abbott et al. (2004)<sup>57</sup>.

### ***May Irregular AC Meetings Increase the Likelihood of Fraud?***

Interviewees were undecided ( $\bar{x}=2.31$ ) on whether fraud increases with irregular AC meetings, with seven (7/16) arguing that detecting and preventing fraud is the IAF's responsibility and that it could only be indirectly linked to AC meetings. This is in line with Bujno et al. (2018)<sup>58</sup>. EAs/Regulators agreed to this significantly more ( $p=0.014$ ) than the MLC representatives<sup>59</sup>.

### ***4.5.3 Regular Participants in Audit Committee Meetings***

Interviewees were asked<sup>60</sup> whether they agree to having the EAs, IAs and the financial controller as regular participants in AC meetings. Twelve (12/16) agreed with their regular participation. This is in contrast with Braiotta et al. (2010)<sup>61</sup>. One IA (1/12) stated that however the meeting should still proceed if they do not attend. Another four (4/16) disagreed to having such participants regularly in AC meetings.

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<sup>57</sup> Vide Section 2.5

<sup>58</sup> Vide Section 2.5

<sup>59</sup> Vide Mann-Whitney Test 4 Statement (B.iii) in Appendix 3.3

<sup>60</sup> Vide Q16.A p.A3.1-10

<sup>61</sup> Vide Section 2.5

Two EAs<sub>(2/4)</sub> upon disagreeing, argued that having the financial controller present throughout all meetings might discourage EAs from discussing certain issues.

Respondents were next asked<sup>62</sup> whether there are any other participants which they would consider to be regularly needed in AC meetings. Table 4.16 below summarises the main responses given.

Other participants which are considered to be needed as regular include the:	Responses (N = 16)
Chief executive officer (CEO)	6
Chief risk officer (CRO)	4
Chief operations officer (COO)	4
Head of IT	3
Compliance officer	1
Chairman	1
Company secretary	1
<b>Total number of responses</b>	<b>20*</b>

\*Some respondents gave more than one participant.

*Table 4.16: Regular Participants in AC Meetings (Qn.16.B)*

Twelve interviewees<sub>(12/16)</sub> commented that some other participants are needed as 'regular'. Most commonly<sub>(6/20)</sub>, the CEO was named because every decision taken ultimately impacts his/her terms of reference. The CRO<sub>(4/20)</sub> and COO<sub>(4/20)</sub> were also mentioned as important regular participants especially if the company is regulated. The Head of IT was also mentioned<sub>(3/20)</sub> especially if the AC lacks technological expertise. Conversely, four interviewees<sub>(4/16)</sub> mentioned that no one is required to be 'regular'.

Furthermore, the interviewees who disagreed with the regular participation of the EAs, IAs and the financial controller, were asked<sup>63</sup> whether they could propose

<sup>62</sup> Vide Q16.B p.A3.1-10

<sup>63</sup> Vide Q16.C p.A3.1-10

any alternative. These<sup>(4/4)</sup> stated that the mentioned participants are to be “*called in meetings as necessary*” depending on the agenda. Moreover, two EAs<sup>(2/4)</sup> argued that meetings should commence with only the AC members and secretary, then such participants are called in in their specific time slots.

#### **4.6 Internal Audit Contribution (Qn.17)**

The fifth section of the interview schedule consisted of one question (Qn.17) concentrating on the relationship between ACs and the IAF.

Respondents were then asked<sup>64</sup> whether, in their view, ACs can achieve their objectives without the contribution of the IAF. Twelve respondents<sup>(12/16)</sup> emphasised that ACs “*definitely cannot*” achieve their objectives without the IAF. However, nine of these<sup>(9/12)</sup> added that the IAF’s contribution is only valued if internal audit reporting is done appropriately and the full audit reports together with executive summaries are passed on to the AC. Conversely, four interviewees<sup>(4/16)</sup> stated that ACs can carry out some of their functions without an IAF but this would be challenging as to “*gaining insight on the functioning of ICs*” and ensuring “*proper governance*”. This is in line with the Chartered Institute of Internal Auditors (2015).

Furthermore, interviewees were asked<sup>65</sup> to rate how effective they consider the internal audit contribution to MLC ACs. Table 4.17 overleaf provides the mean rating score.

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<sup>64</sup> Vide Q17.A p.A3.1-11

<sup>65</sup> Vide Q17.B p.A3.1-11

	Number of interviewees = 16		
	Mean	Median	St. Dev
How effective would you consider the typical internal audit contribution to MLC audit committees?	3.31	3	0.602
<i>Scale from 0 (Highly Ineffective) to 4 (Highly Effective)</i>			

*Table 4.17: Effectiveness of the Internal Audit Contribution (Qn.17.B)*

Respondents agreed that such contribution is effective ( $\bar{x}=3.31$ ). Nine (9/16) argued that internal audit reporting to ACs is effective because it is highly structured to ensure timeliness and appropriate interpretation, while still remaining flexible enough to allow for specific issues that might arise. Furthermore, three agreeing IAs (3/16) insisted that, apart from the normal AC meetings, they hold regular meetings with the AC's chairperson to keep him/her abreast with any developments.

## **4.7 Assessment (Qns.18 – 19)**

The seventh section of the interview schedule consisted of two questions (Qns.18 – 19) focussing on AC assessment.

### **4.7.1 Audit Committee Self-Assessment**

Interviewees were presented with two statements<sup>66</sup> and asked to rate their agreement with each one, based on their experience in the Maltese scenario. It is to be noted that two interviewees failed to answer this question explaining that they did not have the relevant experience. Table 4.18 overleaf presents the mean rating scores.

<sup>66</sup> Vide Q18 p.A3.1-11

	Number of respondents = 14		
	Mean	Median	St. Dev
i. In my experience, Maltese ACs regularly assess their own performance.	2.29	2	1.204
ii. Where assessment is carried out, this include the quality of communications with Boards and external auditors.	2.57	3	1.089
Scale from 0 (Strongly Disagree) to 4 (Strongly Agree)	$\chi^2(1) = 1.800, p = 0.180$		

Table 4.18: Self-Assessment within ACs of MLCs (Qn.18)

### ***Do Maltese ACs Carry Regular Assessment of their own Performance?***

Respondents were undecided ( $\bar{x}=2.29$ ) on this statement. Six<sub>(6/14)</sub> strongly agreed or agreed to this, while most of the others<sub>(5/14)</sub> disagreed, stating that this is to be carried out at Board rather than at AC level. Three<sub>(3/14)</sub> were neutral to this statement arguing that this is only carried out where ACs have matured.

### ***Where Assessment is Carried out, does this Include the Quality of Communications with Boards and EAs?***

Respondents marginally agreed ( $\bar{x}=2.57$ ) to this statement. Eight<sub>(8/14)</sub> strongly agreed or agreed. Six<sub>(6/14)</sub> were neutral or disagreed with this stating that, although ACs maintain regular communications with Boards and EAs, they do not always assess how well this is done.

### ***4.7.2 Optimal Method of Audit Committee Assessment***

Respondents were provided with seven alternative parties<sup>67</sup> who may carry out an assessment on ACs and asked for their opinion as to which would be the optimal party. Respondents were also allowed to provide any alternative not mentioned. Table 4.19 overleaf summarises the responses according to what they rated as being optimal.

<sup>67</sup> Vide Q.19 p.A3.1-12

AC assessment is optimal if it is carried out by...	Number of Interviewees = 16	
	Optimal	Not optimal
E. The Board after receiving the report of an independent qualified consultant	9	7
D. An independent qualified consultant	8	8
B. The other members of the Board	7	9
A. Self-assessment	6	10
C. The chairman of the Board	4	12
G. Shareholders' panel after receiving the report of an independent qualified consultant	2	14
F. The annual general meeting after receiving the report of an independent qualified consultant	1	15

Table 4.19: Optimal AC Assessment (Qn.19)

Opinions regarding this question varied significantly. An assessment by the Board after receiving the report of an independent qualified consultant was the alternative most agreed to<sup>(9/16)</sup>. Respondents pointed out that having an independent party evaluating AC work contributes towards improving ACE, and the Board would be in a better position to conclude its assessment. However, seven respondents<sup>(7/16)</sup> opposed such an alternative arguing that an independent qualified consultant “increases bureaucracy” and is “the root to conflict”. Seven<sup>(7/16)</sup> explained that perhaps the Board on its own would be in the best position to carry out such assessment as it is only the Board which is in the practicable position to carry oversight on the AC throughout the year. Furthermore, most interviewees disagreed with having the assessment carried out by the annual general meeting or the shareholders’ panel, arguing that these are “too distant” to be able to assess ACE. On the other hand, those agreeing<sup>(3/16)</sup> with one of these alternative claimed that it is good practice to give shareholders a voice because they are ultimately the owners of the business.

When presented with the option of providing any alternative to those mentioned above, one IA<sub>(1/16)</sub> explained that within their organisation the IA, risk management unit, the CFO and the Board are asked to assess the AC every year through a formal document. One EA<sub>(1/16)</sub> also argued that the best practice would be to have a mix, namely, an initial part by self-assessment, another part an independent qualified consultant and a final part by the Board. This is in line with FEE (2016)<sup>68</sup>.

#### 4.8 Overall Effectiveness of Audit Committees (Qn.20)

The final section of the interview schedule consisted of one question (Qn.20) focussing on the perceived effectiveness of ACs. Interviewees were finally asked<sup>69</sup> to rate how effective are ACs in MLCs. Table 4.20 below provides the mean rating score.

	Number of interviewees = 16		
	Mean (%)	Median (%)	St. Dev (%)
How effective are ACs in Malta?	72.50	70	12.383
<i>Scale from 0 (Highly Ineffective) to 100 (Highly Effective)</i>			

*Table 4.20: Perceived Effectiveness of ACs in MLCs (Qn.20)*

Respondents agreed that ACs in MLCs are adequately effective with a mean of 72.5%. Twelve interviewees<sub>(12/16)</sub> added that there is room for improvement in ACE and this varies with the organisation, their resources and the importance given to the AC. Furthermore, two<sub>(2/12)</sub> argued that in the light of certain scandals involving sanctions by regulators, the question arises; *“if ACs did their job so well, why did this happen?”*.

<sup>68</sup> Vide Section 2.7

<sup>69</sup> Vide Q20 p.A3.1-12

## **4.9 Conclusion**

This chapter presented the findings from the semi-structured interviews conducted. The next chapter provides a thorough discussion of these findings.

# **DISCUSSION**

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## **CHAPTER 5**

## 5.1 Introduction

This chapter discusses the findings of the study. As shown in Figure 5.1 below and 5.2 overleaf, the discussion relates to the effectiveness of Maltese ACs with respect to the five major determinants in the literature<sup>70</sup>. Section 5.2 considers composition, Section 5.3 authority and resources, Section 5.4 discusses diligence and Section 5.5 the internal audit contribution, while Section 5.6 focuses on assessment. These Sections are then followed by Section 5.7, which discusses the extent to which ACs in MLCs are effective. Finally Section 5.8 concludes the chapter.

As previously stated, listed company ACs need to include an adequate mix of the stated five determinants as these all contribute to ACE<sup>71</sup>. This is analogous to the five senses which together contribute to the effectiveness of the human body: the taste of composition, the sight of authority and resources, the hearing of diligence, the touch of the internal audit contribution and the smell of assessment.



*Figure 5.1: The Five Senses of Effectiveness*

<sup>70</sup> Vide Section 2.2 for example DeZoort et al. (2002) and the ACI (2017)

<sup>71</sup> Vide Section 4.2



Figure 5.2: Outline of Chapter 5

## 5.2 Composition – Taste

As stated earlier<sup>72</sup> and also sustained in the findings<sup>73</sup>, AC composition consists of four major elements. These are: the chairperson appointment, the AC size, member competence and member independence.

### ***5.2.1 Is the Appointment of the Audit Committee Chairperson to be Regulated?***

Collier (1993)<sup>74</sup> argued that in most companies, the Board automatically appoints NEDs as AC members and selects the most competent one as the chairperson, sometimes after the recommendation of the AC members themselves. The findings<sup>75</sup> also indicate that an AC chairperson needs to be appointed by the Board since MLC directors undoubtedly have the capacity to appoint the proper chairperson. In fact, as also confirmed in the findings, this is common practice in MLCs. On the other hand, it is probably optimal that AC members do not have a say in the chairperson's appointment. Moreover, some interviewees also argued that the usual interpretation of chairperson competence is restricted to that in accounting/auditing areas. Furthermore, while this may be understandable, the findings indicate that for ACE to be enhanced, the selection of the chairperson must not merely pivot on such competence but, perhaps even more importantly, also takes his/her independence well into consideration.

The FRC (2016) and Baldacchino et al. (2018)<sup>76</sup> took this a step further by arguing that the Board needs to heed the nominations of the Nomination Committee when appointing AC members and the chairperson. Interestingly, the findings<sup>77</sup> indicate that EAs and Regulators agreed more to this alternative than the MLC representatives. This may suggest that the more independent parties emphasise the objectivity aspect more in such an appointment. This gives rise to the question

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<sup>72</sup> Vide Section 2.3

<sup>73</sup> Vide Section 4.3

<sup>74</sup> Vide Section 2.3.1

<sup>75</sup> Vide Section 4.3.1

<sup>76</sup> Vide Section 2.3.1

<sup>77</sup> Vide Section 4.3.1

as to whether it is time perhaps to make the Nominations Committee a mandatory committee within MLCs – and this to ensure that the appropriate members and chairperson are appointed as part of the AC.

### **5.2.2 Audit Committees – Too Large or Too Small?**

Although the Listing Rules specify that ACs need to be composed of at least three members<sup>78</sup>, AC size remains a highly controversial aspect of AC composition. Karamanou and Vafeas (2005) and Camilleri (2016)<sup>79</sup> suggest that, while larger ACs might benefit from a wider degree of expertise and skills, the increased process inefficiencies as well as the dispersion of power could counterfire. Indeed the findings<sup>80</sup> confirmed that larger ACs benefit from wider skillsets. However, it is ultimately the time which AC members have at their disposal which will impact their effectiveness. Moreover, interviewees<sup>81</sup> argued that, although smaller ACs may result in more unanimity and fewer differences, this is not necessarily indicative of effectiveness. Furthermore, contrary to the literature<sup>82</sup>, the findings<sup>83</sup> suggest that, with more members, fewer meetings are typically held in view of the issue of agreeing on the meeting dates. Additionally, even if meeting frequency remains satisfactory, the presence of too many speakers in a meeting might result in participation ineffectiveness.

Ultimately, the findings<sup>84</sup> indicate that the appropriate AC size is not a one-size-fits-all but varies particularly with business complexity and the resulting variety in member skillsets. As such, it would probably be beneficial if a range rather in addition to the minimum number of members is indicated in the Listing Rules. In addition to retaining the rarely disputed relevance of a minimum, this would also introduce an allowance for the circumstantial flexibility needed by different MLCs.

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<sup>78</sup> Vide Section 2.3.1

<sup>79</sup> Vide Section 2.3.2

<sup>80</sup> Vide Section 4.3.3

<sup>81</sup> Vide Section 4.3.2

<sup>82</sup> Vide Section 2.3.2 for example Al-Najjar (2011)

<sup>83</sup> Vide Section 4.3.4

<sup>84</sup> Vide Section 4.3.4

Rather than being prescriptive, the Rules may also permit such a range to be exceeded, subject to well-grounded justification.

### **5.2.3 What is Financial Competence and is this Enough?**

DeZoort et al. (2002)<sup>85</sup> emphasises that AC member competence is an essential precondition for ACE. In this regard, the regulatory framework mandates that at least, one member is to be competent in accounting and/or auditing; and that the AC as a whole is competent in the company's specific sector may not be enough. What level of financial competence would suffice? Probably, even the quote by Micallef (2015) of having "*an individual with a financial mind*" does not resolve the issue. In fact, this study has found clear indications<sup>86</sup> that a sufficient level of competence in accounting/auditing would entail someone being both warranted in accounting/auditing and having a post-warrant number of years of experience in the field. In line with BRC (1999)<sup>87</sup>, interviewees also argued that, the required expertise must be enough for AC members to fully understand ever-more-complex financial statements.

Furthermore, as discussed earlier<sup>88</sup>, the corporate scandals of the 20<sup>th</sup> century and the financial crisis of 2007-2009 resulted in regulatory agencies heavily scrutinising ACs, placing more onus on them and further extending their composition and responsibilities. Clearly, this suggests the overriding belief of regulatory authorities that if better equipped, ACs could do a better job. A relevant point of issue here is whether financial competence is in itself sufficient, even if it is defined more widely as argued above. In this context, the findings<sup>89</sup> indicate that the more diversity in the background of skills and experiences of the AC members, the more effective will such an AC be – a diversity as yet clearly lacked by Maltese ACs. It is probably best if such diversity includes formal qualifications in law, compliance and IT, as has also been suggested by the interviewees<sup>90</sup>.

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<sup>85</sup> Vide Section 2.3.3

<sup>86</sup> Vide Section 4.3.5

<sup>87</sup> Vide Section 2.3.3

<sup>88</sup> Vide Section 1.2.3

<sup>89</sup> Vide Section 4.3.6

<sup>90</sup> Vide Section 4.3.7

However, one probably needs to ensure that such diversity does not come at the expense of lower financial acumen.

Regarding specific sector competence, in line with ECODA and PwC (2016)<sup>91</sup>, the findings<sup>92</sup> suggest that there is no need for the majority of members to be competent in a company's specific sector as other competences contribute to ACE. In line with this, interview respondents pointed out that the majority of AC members in MLCs do not actually have specific sector competence. In this light, the regulatory framework specifying the need for ACs as a whole to have specific sector competence probably needs to be clarified so as to limit such specific competence to a minimum, say one or two members.

#### ***5.2.4 Member Independence – Fact or Fiction?***

As already stated earlier in this chapter and also in the literature<sup>93</sup>, independence is of such importance that it needs to be a principal determinant when appointing AC members. Interviewees emphasised that nothing is achieved if the members do not retain a clear mindset to question and challenge management<sup>94</sup>. However, there is no clear definition of what makes a director independent but only suggested guidelines. The findings indicate that such guidelines are accepted by MLCs and that once they hold true, members are deemed to be independent. Yet, independence in fact still remains a frame of mind and it is only independence in appearance which may be determined by compliance to the regulatory framework. Beyond this, attempts may only be made to determine real independence subjectively on a case-by-case basis and this in line with FEE (2016)<sup>95</sup>. Furthermore, within the Maltese context, there is the further limitation of a small state with a limited pool of qualified persons<sup>96</sup>. Could it be that MLCs find themselves necessarily choosing from the same pool of persons whom they closely know and trust? Perhaps one way out could be that of going beyond

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<sup>91</sup> Vide Section 2.3.3

<sup>92</sup> Vide Section 4.3.6

<sup>93</sup> Vide Section 5.2.1 and 2.3.4

<sup>94</sup> Vide Section 4.3.8

<sup>95</sup> Vide Section 2.3.4

<sup>96</sup> Vide Section 4.3.8

Maltese shores to trace potential AC members, or at least, of going beyond the circle of close relationships.

Interestingly, when provided with the option, interviewees agreed that AC members should be made to formally declare their independence<sup>97</sup>. Instead of setting up more guidelines as to what considerations determine AC member independence, regulators could probably enhance AC member accountability by making such a formal declaration by them a statutory requirement, prior to their acceptance of AC membership. However, further research is needed in this regard.

### **5.3 Authority and Resources – Sight**

AC authority is claimed by DeZoort et al. (2002)<sup>98</sup> to be drawn from its responsibilities and thus mainly hinges on three main factors. These are: recommending the appointment of the EA, overseeing the financial reporting process, and monitoring ICs and RM systems. Moreover, it requires adequate access to resources for the AC to enforce its authority<sup>99</sup>.

#### ***5.3.1 Authority – Is the Audit Committee Doing Enough?***

##### ***Is AC Deciding Better than Recommending the External Auditor Appointment?***

According to Dhaliwal et al. (2015)<sup>100</sup>, regulatory agencies in America were of the opinion that the EA independence was being jeopardised as auditors were becoming increasingly sympathetic to the management's position. In fact, with the enactment of new EP regulations<sup>101</sup>, the AC was made responsible for recommending an EA to the Board so that management association in the selection process would be minimised. However, the findings<sup>102</sup> were

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<sup>97</sup> Vide Section 4.3.8

<sup>98</sup> Vide Section 2.4

<sup>99</sup> Vide Section 2.4.4

<sup>100</sup> Vide Section 2.4.1

<sup>101</sup> Vide Section 2.4.1

<sup>102</sup> Vide Section 4.4.1

controversial as to whether, with such an AC recommendation, management association did in fact decrease. Perhaps it is time for the Listing Rules to allow the AC to select the EA and not merely recommend to the Board. However, even with an AC appointment, if management is still consulted in the process, this could be self-defeating. Moreover, this has been the US experience, where according to Looknanan-Brown (2011) and Dhaliwal et al. (2015)<sup>103</sup>, although the SOX has made the AC directly responsible in appointing the EA, management affiliation continued to be seen in the selection process. Probably, rather than being a matter of the AC recommending versus deciding, it is more a question of how widely the AC consults prior to its action.

### ***Is the Oversight of the Financial Reporting Process a Burden for Audit Committees?***

As explained by Braiotta et al. (2010)<sup>104</sup>, financial reporting is becoming more complex, intricate and regulated. Yet the AC is still charged to oversee the financial reporting process, albeit having several other responsibilities. However, the strong indications<sup>105</sup> are that Maltese ACs should still keep fulfilling such a responsibility and that there is no need to have a separate Financial Reporting Committee charged with overseeing the financial reports prior to ACs. In fact, in line with the ACI (2017)<sup>106</sup>, interviewees believe<sup>107</sup> that, as long as ACs are given the required information in time and also kept abreast with any significant developments, they would also be effective in fulfilling such a responsibility. While, such a separate Committee could itself contribute to the robustness of the financial reporting process, with the AC retaining such a responsibility, more system coherence and integration as well as better oversight may probably be attained.

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<sup>103</sup> Vide Section 2.4.1

<sup>104</sup> Vide Section 2.4.2

<sup>105</sup> Vide Section 4.4.2

<sup>106</sup> Vide Section 2.4.2

<sup>107</sup> Vide Section 4.4.2

### ***Are Audit Committees to Monitor Risk Management Systems?***

As explained in the literature<sup>108</sup>, one of the responsibilities of ACs is to monitor IC and RM systems without infringing on their independence. However, although in recent years several MLCs have developed their separate RM oversight functions, the findings indicate that both a separate committee and a joint committee could be doable. On the one hand, it may be effective if ACs continue to oversee the RM systems as long as there are adequate risk-related competences among AC members<sup>109</sup>. One argument towards taking this stance is that since, in any case, the internal audit and risk functions need to liaise closely in their work, it may be more fruitful to have them reporting to the same joint committee. Contrastingly and in line with the American study of Bujno et al. (2018)<sup>110</sup>, one may claim that it might be more effective if a separate RM oversight committee is given responsibility for monitoring RM systems and this because of the drastically increased significance in recent years of risk management and oversight<sup>111</sup>. In this connection, the current regulatory framework makes it mandatory for credit institutions to have such a separate RM Committee mainly due to the higher significance being given to their regulation. Probably this regulatory framework is an acceptable compromise because the responsibility of ACs for monitoring RM systems is thus only retained in those industries which are not too significantly exposed to risks.

### ***5.3.2 Resources – Are they Adequate?***

According to DeZoort et al. (2002)<sup>112</sup>, adequate AC oversight depends on whether the AC has the necessary resources to function. The findings<sup>113</sup> confirmed that unrestricted access to information, staff and management that ACs might require is invariably beneficial and enhances ACE, with the proviso that such access is well taken advantage of. Furthermore, the findings indicate that AC resources within MLCs are generally sufficient to ensure their

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<sup>108</sup> Vide Section 2.4.3 for example FRC (2016) and Listing Authority – Malta (2019)

<sup>109</sup> Vide Section 4.4.3

<sup>110</sup> Vide Section 2.4.3

<sup>111</sup> Vide Section 4.4.3

<sup>112</sup> Vide Section 2.4.4

<sup>113</sup> Vide Section 4.4.4

effectiveness. However, the fact that MLC representatives are more of the opinion than EAs and Regulators that such resources are sufficient indicates that it could be that the available resources are not being utilised in the best possible way. In this connection, improved communications among the stakeholders including Regulators, EAs and also shareholders, could promote better use of such resources or at least align their different perceptions on the matter. The FEE (2016)<sup>114</sup> advocates such improved communications if the interested parties are to undertake their responsibilities better. Moreover, further research is needed in this regard.

## 5.4 Diligence – Hearing

One valid proxy used to measure diligence is “*the number of AC meetings held per year*” (DeZoort et al. 2002)<sup>115</sup>. Although the Listing Rules mandate a minimum of four meetings every year, Aldamen et al. (2012) and DeZoort et al. (2002) contend that the more meetings held, the more effective is the AC oversight likely to be. It is clear from the findings<sup>116</sup> that the degree of ACE is influenced by the frequency of AC meetings. However they also indicate that ACE is influenced by the quality of such meetings. Furthermore, although mandating a statutory minimum number of meetings might ensure ACE, it might be wiser to set a period which cannot elapse without a meeting being held<sup>117</sup>. This could ensure that AC oversight of operations is not sporadic but continuous. Notwithstanding this, the number of meetings typically held by ACs in MLCs is claimed to be sufficient for ACs to be effective. Yet, the suspicion looms that some of these ACs meet only to fulfil the minimum requirements of the law. As such, it might therefore be wiser to compel such committees to meet more by setting the statutory minimum to six meetings per year.

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<sup>114</sup> Vide Section 2.4.4

<sup>115</sup> Vide Section 2.5

<sup>116</sup> Vide Section 4.5.2

<sup>117</sup> Vide Section 4.5.1

Several authors have argued that certain problems tend to arise if insufficient meetings are held<sup>118</sup>. In this regard, the findings<sup>119</sup> point towards irregular AC meetings leading to unsolved financial reporting problems and an increased number of restatements although not necessarily to the higher probability of fraud. Contrastingly, the argument may be made that such issues do not depend on the frequency of AC meetings but on IAF diligence. In fact, this appears to be a major belief of MLC representatives and yet significantly less that of EAs and Regulators. Could this indicate lingering MLC dilemmas about the possible roles of their ACs? Perhaps, it would be beneficial if all three parties exchange their opinions more about their perceived remits of ACs so that these are ultimately best established.

Furthermore, the FEE (2016) explained that AC meetings should not be taken over by management while Braiotta et al. (2010) argued that management should not even be present in AC meetings<sup>120</sup>. In contrast, the findings<sup>121</sup> suggest that the financial controller, the CEO, CRO and COO need to participate regularly in AC meetings together with EAs and IAs, though possibly not for the whole duration of the meetings. However, it is probably better that such participants, with the exception of IAs and possibly EAs, who are not part of management, are only invited to the meetings as necessary, depending on the agenda. They might also be informed as to when AC meetings are being held so that they remain on call for possible questioning or consultation by the AC. Such arrangement might help to ensure that strong member of management hijacks the AC meetings.

## 5.5 Internal Audit Contribution – Touch

According to Cadbury (1992)<sup>122</sup>, the role of IAFs is fundamental in aiding ACs to achieve their objectives as IAs continuously monitor the company's basic controls and processes. Moreover, the IAF provides the organisation's governing bodies

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<sup>118</sup> Vide Section 2.5 for example Abbott et al. (2004) and Beasley, Carcello et al. (1999)

<sup>119</sup> Vide Section 4.5.2

<sup>120</sup> Vide Section 2.5

<sup>121</sup> Vide Section 4.5.3

<sup>122</sup> Vide Section 2.6

with independent assurance. The findings<sup>123</sup> do confirm that ACs “*definitely cannot*” or “*would find it extremely challenging*” to achieve their objectives without the contribution of the IAF. The question, therefore, undoubtedly arises as to why IAFs are not mandated by the Listing Rules although ACs are. Probably it would be a great enhancement to ACE if the introduction of IAFs in MLCs is also mandated.

## 5.6 Assessment – Smell

The ACI (2017)<sup>124</sup> emphasises that it is essential for ACs to carry out a regular assessment of their own activities. Moreover, since the type of assessment is not actually specified, this often takes the form of self-assessment. The findings<sup>125</sup> indicate that such self-assessment is not being carried out by all ACs in MLCs but only by mature ACs. Furthermore, when such an assessment is carried out, it might not include AC communication with Boards and EAs. This lack of assessment might actually hinder the effectiveness of such communication and that of the AC.

Additionally, the FEE (2016)<sup>126</sup> pointed out that since ACs have been given greater importance, then perhaps an external stakeholder should be involved in their assessment process. In this regard, the indications<sup>127</sup> are that such external assessment might be needed in Maltese ACs. In fact, the preference seems to be for an independent qualified consultant being involved in the AC assessment process<sup>128</sup>.

An issue that arises in this context is the qualifications, experience and required independence of such a consultant. Again, would it be better for such a person or entity to have financial competences or, insofar as is possible, wider

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<sup>123</sup> Vide Section 4.6

<sup>124</sup> Vide Section 2.7

<sup>125</sup> Vide Section 4.7.1

<sup>126</sup> Vide Section 2.7

<sup>127</sup> Vide Section 4.2

<sup>128</sup> Vide Section 4.7.2

competences on the same basis as the collective competences of the AC? Furthermore, it may be that such persons or entities are not yet easily available in a small country. Perhaps, further research is needed in this regard.

## 5.7 The Million-Dollar Question: Are Audit Committees in Maltese Listed Companies Effective?

Finally, the findings<sup>129</sup> seem to indicate that ACs in MLCs are adequately effective, yet there still remains room for improvement albeit the recent developments. Table 5.1 below depicts the results of the Spearman Test<sup>130</sup> as well as the mean rating scores, in descending order, for the individual questions.

Relation with Qn.20	Mean*	Spearman Correlation	P-value
Qn.17.B – Re Internal Audit Contribution	3.31	0.155	0.567
Qn.14.C – Re Diligence	3.00	0.023	0.931
Qn.13.C – Re Authority and Resources	2.94	<b>0.650</b>	<b>0.006*</b>
Qn.15.A – Re Diligence	2.94	0.461	0.073
Qn.18.ii – Re Assessment	2.57	0.119	0.684
Qn.5.A – Re Composition	2.31	0.227	0.397
Qn.18.i – Re Assessment	2.29	0.174	0.551
Qn.7.A.2 – Re Composition	2.19	0.185	0.492
Qn.7.B.2 – Re Composition	2.06	0.408	0.117
<b>Average Mean Rating Score of 9 Qns.</b>	<b>2.63</b>	<b>Friedman Test: <math>X^2(1) = 1.000, p = 0.317</math></b>	
<b>Mean Rating Score of Overall Qn. 20</b>	<b>2.90</b>		

\*0 = Strongly Disagree/Highly Ineffective/Not Sufficient at All

4= Strongly Agree/Highly Effective/Highly Sufficient

Table 5.1: Strength of Relationship with Qn.20

As may be seen, the Spearman Correlation between the interviewees' opinion on each specific individual question targeting the determinants of ACE and their

<sup>129</sup> Vide Section 4.9

<sup>130</sup> Vide Appendix 3.4

opinion derived from the overall question (Qn.20) is positive, thus indicating that participants who agreed to the individual questions also agreed to the overall question and vice versa. However, the  $p$ -value of such positive relationships indicates that they were not significant, but rather weak, with the exception of the relationship of the second determinant – AC resources (Qn.13.C) with the overall question. The interpretation in the latter case is that interviewees who held the opinion that AC resources in MLCs are sufficient for them to achieve their objectives, argued to a significantly similar degree that ACs in MLCs are in general effective.

Furthermore, the interviewee impression derived from the overall question seems to be somewhat optimistic ( $\bar{x}=2.90$ ) with respect to effectiveness while if one compares such overall impression with that indicated by the average mean rating scores of the individual nine questions, then one finds that the latter is relatively marginally (although not significantly) less effective ( $\bar{x}=2.63$ ).

One may also note substantial variations between most specific individual questions and the overall question, such variations being therefore indicative of either lower or higher perceptions of ACE in the response to such questions. In particular, interviewee perceptions relating to the internal audit contribution (Qn.17.B) is much more optimistic ( $\bar{x}=3.31$ ) than their overall perception, while interviewee perception of company specific-sector competence (Qn.7.B.2) is much more pessimistic ( $\bar{x}=2.06$ ).

Therefore, the indications are that Maltese ACs are generally effective but also that such effectiveness could be higher and that certain determinants of ACE are as yet much less weak.

## 5.8 Conclusion

This chapter discussed the research findings relating to the effectiveness of ACs in MLCs with respect to the five determinants of composition, authority and resources, diligence, internal audit contribution and assessment. The following

chapter will now present a summary of the findings and concludes this dissertation by presenting a number of recommendations.

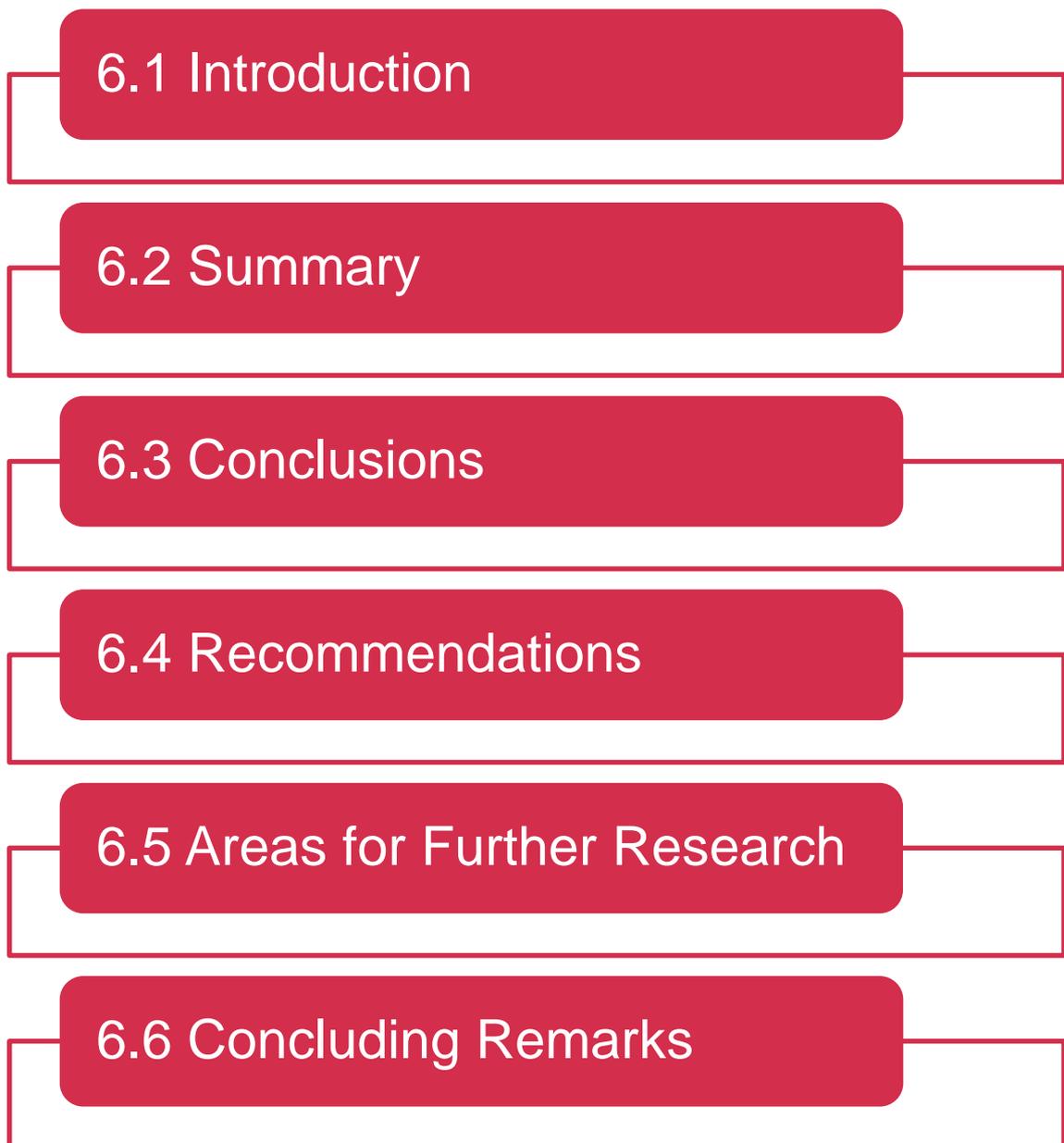
# **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

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CHAPTER 6

## 6.1 Introduction

This chapter concludes the dissertation. As depicted in Figure 6.1 below, Section 6.2 summarises the findings of this research study while Section 6.3 outlines the main conclusions. Subsequently, Section 6.4 identifies a number of recommendations and Section 6.5 postulates some areas for further research. Finally, Section 6.6 provides the concluding remarks.



*Figure 6.1: Outline of Chapter 6*

## 6.2 Summary

The objective of this study was to assess and analyse the effectiveness of ACs within MLCs with respect to the following five determinants: composition, authority and resources, diligence, internal audit contribution and assessment.

To achieve such objectives, a mixed-methods research approach was adopted. Sixteen semi-structured interviews were conducted with ten MLC representatives, four EAs and two Regulators.

The findings indicate that there is still some disagreement as to whether MLC ACs are effective or not. The appointment of AC members is left up to the discretion of the Board who tends to appoint the NEDs to the AC without much consideration for their competences. There also seems to be a controversy as to whether Maltese AC members actually and effectively satisfy the independence criteria. Moreover, although financial competence is required on ACs, there is no statutory need for formal qualifications although it is desired in practice. Additionally, ACs might be over-burdened with too many responsibilities and not enough available resources for the AC to reach its objectives. AC meetings held by MLCs seem to be surpassing the minimum requirement stipulated by law and this is perceived to be contributing to their effectiveness. Moreover, although IAFs are seen as fundamental for ACs to reach their objectives, the lack of a statutory requirement to establish IAFs could be negatively impacting ACE. Additionally, although there seems to be a general opinion that AC assessment is necessary, opposition is likely to be present if one had to regulate this better and perhaps involve an independent third party in the process.

## 6.3 Conclusions

This study concludes that, while Maltese ACs are generally effective, such effectiveness could be higher and certain determinants of ACE are as yet much less effective. Therefore, more needs to be done in terms of regulation and also in terms of better communication among the relevant parties.

While the regulatory framework does regulate AC composition, a revision of such regulation might aid in increasing ACE. The appointment of members and the chairperson is still left up to the discretion of the members of the Board, who should have the necessary expertise and experience to make the right decision, even if this leaves the possibility of preferential appointments. Moreover, although smaller ACs seem to suffer less from process inefficiencies and enjoy more unanimity, larger ACs might benefit from a wider degree of expertise and skills and therefore, it might not be wise to mandate a maximum by law. In order to avoid a one-size-fits-all approach, mandating a range of AC members could allow the flexibility desired in this regard. As yet the Listing Rules do not clarify what is exactly meant by AC member competence and this leaves a dilemma about the relative significance of experience as against qualifications. Additionally, independence still is, and remains, a subjective issue. Although independence in appearance could perhaps be enhanced by the introduction of a mandatory declaration of independence, in practice independence always remains a question of frame of mind.

With respect to authority and resources of ACs, the study concludes that the AC remit could be widened in certain instances and narrowed in others to ensure effectiveness while reducing the AC's burden. In the first instance, although the AC is responsible in recommending an EA to the Board, management association in the process is still present. Moreover, ACs are still the committee charged with overseeing the financial reporting process and RM systems in most MLCs. In this regard, it is time to widen the remit of the AC to authorise it to choose, rather than to merely recommend the EA. At the same time, such remit is to be narrowed by alleviating the AC from the burden of overseeing the financial reporting process and RM systems. Finally, although AC resources might be sufficient for ACs to achieve their objectives, they probably need to make a better case at persuading stakeholders that such resources are being put to the best possible use.

AC diligence is an essential prerequisite for ACE. Most MLCs seem to understand the importance of having sufficient AC meetings. However, there still

remain some ACs who seem to meet simply to undertake the expected rituals. Amendments to the Listing Rules might help in this regard. Moreover, controversy exists as to whether AC meetings are actually being taken over by management. Whatever the case, it is probably better if the regulatory framework imposes safeguards to ensure free and effective discussions in such meetings.

With respect to the internal audit contribution to ACs, this study concludes that this is an extremely valued resource within MLCs. However, paradoxically the Maltese Listing Rules do not as yet mandate the statutory obligation to establish IAFs within MLCs. This is perhaps one of the most significant effectiveness gaps within the regulatory framework crying to be addressed.

In terms of AC assessment, this study concludes that the present assessments being carried out only by some MLCs, which are commonly self-assessments, leave much to be desired. There seem to be increased calls for improved and more objective assessments which may be precipitated by appropriate legislation.

## 6.4 Recommendations

This study recommends that:

***i. the Nomination Committee becomes mandatory in MLCs***

*(Section 5.2.1)*

It is recommended that the Listing Rules make it mandatory for MLCs to establish a Nomination Committee which, among other responsibilities, would be charged with recommending both the AC chairperson and members to the Board. This would enhance the vetting of AC members and ensure that they are people with the right competences and effectively independent.

**ii. the Listing Rules stipulate a range for the size of ACs**

*(Section 5.2.2)*

The Listing Rules should, together with specifying the minimum number of AC members, establish an appropriate range for the size of ACs. This would allow MLCs to take their own circumstances into consideration when establishing ACs. Moreover allowing MLCs to go beyond the range, with adequate justification, would also provide the necessary lee-way in the case of significantly large and complex MLCs.

**iii. the Listing Rules specify more objective criteria for member competences** *(Section 5.2.3)*

The criteria for competence in accounting and/or auditing need to be clearer and more objective if the right members are to be appointed to ACs. In particular, the need for qualifications together with a number of years of experience has to be explored. Moreover, the Listing Rules could specify that other competences, such as specific-sector competences, may also be considered to be required in ACs with the proviso that the financial competence remains significantly present.

**iv. the Listing Rules mandate a formal declaration of independence from AC members** *(Section 5.2.4)*

It is recommended that the Listing Rules make it mandatory for AC members to sign a formal declaration of their independence. Although this might still not give full assurance as to their effective independence, it will provide shareholders with a formal document to hold AC members accountable should they clearly breach their independence.

**v. ACs are made responsible to appoint the external auditor**

*(Section 5.3.1)*

Making ACs responsible to actually appoint the EA rather than simply put forth recommendations in this aspect, would render the process more independent. Allowing ACs to take the final decision after a wide consultation process and on

ensuring no conflicts of interest may perhaps eliminate undue management association in the process.

**vi. more emphasis is placed on enhanced communications between ACs and external parties** (Section 5.3.2, 5.4 and 5.7)

There seems to be a gap in the communication between ACs and EAs and Regulators, especially when it comes to the sufficiency of AC resources and the remit of ACs. Therefore, more emphasis needs to be placed on such lines of communication by establishing the requirement that ACs are to pass on an annual report to their stakeholders including Regulators, EAs and also shareholders, clarifying their responsibilities and informing them of the activities carried out during the year.

**vii. management participation in AC meetings should be subject to specific to Listing Rule limitations** (Section 5.4)

In order to enable all participants to freely discuss any issues or concerns with the AC, the Listing Rules need to be amended to include provisions to the effect that management cannot be a regular participant in AC meetings but can attend at the invitation of the AC according to the agenda.

**viii. the IAF becomes mandatory in MLCs** (Section 5.5)

It is highly challenging, if not at all impracticable, for ACs to achieve their objectives without the contribution of IAFs. In the light of this, it is high time for the IAF to be made mandatory for all MLCs.

**ix. AC assessment is better regulated** (Section 5.6)

The self-assessments commonly being carried out by ACs fall short of achieving the much desired call for an effective review of AC performance. Thus, the Listing Rules may clarify how such an assessment is to be carried out. Furthermore, it is recommended that the Listing Rules mandate that an independent professional consultant is engaged in the process to submit a performance report to the whole Board. Such reports could include a record of the number of meetings attended

by each member and also an assessment of the level of contributions to the meetings, among other criteria.

## 6.5 Areas for Further Research

This study identified the following areas requiring further research:

***i. Diversity within Maltese Audit Committees: An Analysis***

As stated in Chapter One, this study has excluded considerations of diversity in AC composition. The extent of the influence of diversity to ACE is as yet unclear. Therefore, such a study could also add a contribution to the current literature.

***ii. The Independence of Audit Committee Members: A Study***

*(Section 5.2.4 and 6.4(iv))*

This study may assess how such a declaration may be drawn up to add assurance to the perceived and effective independence of AC members.

***iii. Annual Report of the Audit Committee (Section 5.3.2 and 6.4(vi))***

This study may assess how such a report is to be drawn up, the information required to be passed on to the stakeholders and also identify such stakeholders.

***iv. Audit Committee Assessment: A Study (Sections 5.6 and 6.4(viii))***

This study may include ways in which AC assessment can be enhanced. Analysing whether the introduction of an independent consultant is needed in the process or whether a more regulated self-assessment should be introduced could be carried out.

***v. Audit Committees in Maltese Companies: The Perspectives of Board Members and Risk Managers (Section 3.8)***

This study may assess the perceptions of these two major parties of ACs whose perceptions were omitted from this study and whose perceptions may result in useful analysis regarding ACE.

## 6.6 Concluding Remarks

Elements of controversy tend to remain with respect to the effectiveness of ACs given that different participants tend to evaluate such effectiveness limitedly from their own perspective. As has been seen, increased regulation and inter-party communications may be helpful in this regard. Furthermore, by their understanding of how ACs may add real value to their organisations, MLCs will be able to stay ahead in ensuring sound governance in the interest of their stakeholders. In this context, it is clear that, in the same manner that all the five senses are essential for the human body in order to function properly, the five common aspects analysed in this study are all needed if ACs are to achieve their objectives. Indeed, as stated by one MLC representative, *“it ultimately boils down to the effectiveness of the senses themselves to have a truly effective human body”*.

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# APPENDICES

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## Appendix 1.1 Maltese Equity-Listed Companies

This Appendix lists MLCs whose equity was listed on the MSE as at 31<sup>st</sup> March 2020.

1. Bank of Valletta p.l.c.
2. HSBC Bank Malta p.l.c.
3. Lombard Bank Malta p.l.c.
4. Mapfre Middlesea p.l.c.
5. Simonds Farsons Cisk p.l.c.
6. GO p.l.c.
7. International Hotel Investments p.l.c.
8. Plaza Centres p.l.c.
9. GlobalCapital p.l.c.
10. FIMBank p.l.c.
11. Malta International Airport p.l.c.
12. Santumas Shareholdings p.l.c.
13. Medserv p.l.c.
14. Grand Harbour Marina p.l.c.
15. MaltaPost p.l.c.
16. RS2 Software p.l.c.
17. MIDI p.l.c.
18. Malita Investments p.l.c.
19. Tigne Mall p.l.c.
20. Malta Properties Company p.l.c.
21. PG p.l.c.
22. Trident Estates p.l.c.
23. Main Street Complex p.l.c.
24. BMIT Technologies p.l.c.
25. Harvest Technology p.l.c.

## **Appendix 3.1 Interview Schedule**

This appendix presents the interview schedule that was used during the semi-structured interviews conducted for the purpose of this dissertation. The schedule further presents the responses for each Likert scale question, in **bold** and *italics*.

## **Section 1 – Determinants of Audit Committee Effectiveness**

*This study aims to assess and analyse the perceived effectiveness of Audit Committees<sup>131</sup> (AC) within Maltese Listed Companies (MLCs).*

1. To what extent do you agree with the following statements? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree<sup>132</sup>), adding comments, if any:*

The degree of effectiveness of the AC depends primarily on its:	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
i. Composition	0	0	0	5	11
ii. Authority	0	0	1	5	10
iii. Resources (ex. budget)	1	0	3	8	4
iv. Diligence	0	0	1	4	11
v. Availability of internal audit	0	0	0	2	14
vi. Assessment	1	0	1	8	6

<sup>131</sup> Vide Section A2 p3.1-15

<sup>132</sup> Vide Section A2 p3.1-15

## **Section 2 – Composition of the Audit Committee**

2.

A. To what extent do you agree with the following statements? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree), adding comments, if any:*

An AC chairperson needs to be:	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
i. Appointed by the Board	0	0	2	7	7
ii. Recommended by the AC itself and officially appointed by the Board	1	2	7	3	3
iii. Nominated by the nomination task force and officially appointed by the Board	0	4	5	5	2

B. In your view what is the common practice in Malta with respect to the appointment of the AC chairperson?

3. To what extent do you agree with the following statements? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree), adding comments, if any:*

The following are likely to be the benefits of having an AC limited to the statutory minimum number of members (i.e. 3):	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
i. Fewer process inefficiencies	0	3	5	8	0
ii. Fewer differences	0	5	7	3	1
iii. Efficient use of time	0	2	4	8	2
iv. More unanimity	0	2	9	2	3

4. To what extent do you agree with the following statements? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree), adding comments, if any:*

The following are likely to be the benefits of larger ACs (i.e. having more than 3 members): <b>An oversight function...</b>	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
i. with a wider degree of expertise and skills	0	0	0	10	6
ii. which enhances more deeply the financial performance	1	4	8	2	1
iii. which enhances more widely the overall oversight	1	0	2	8	5

5.

A. To what extent do you agree with the following statement? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree), adding comments, if any:*

	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
The degree of effectiveness of an AC is influenced by the size of the AC.	0	1	11	2	2

B. Maltese law stipulates a minimum number of AC members required (as three).

- i. Do you think this is an appropriate minimum?
- ii. Do you think that a maximum threshold should also be set?
- iii. What, in your opinion, determines the size of the AC?

6. At least one member of the AC should be competent in accounting and/or auditing, according to Maltese listing rules.

A. What do you consider as a sufficient level of competence?

B. Do you believe that having a member with expertise as in (a) is essential to its proper functioning?

7. To what extent do you agree with the following statements? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree), adding comments, if any:*

	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
A.1. The more diversity of skills, background and experiences of the members of the AC, the better such an AC.	0	0	0	6	10
A.2. To my knowledge, most ACs in Malta actually have sufficient diversity of skills, background and experiences.	0	3	8	4	1
B.1. In addition to A.1, in order to be competent, the AC needs to have the majority of members competent in the specific sector in which the company is operating.	0	2	9	3	2
B.2. To my knowledge, the majority of members in Maltese ACs are actually competent in the specific sector in which the company is operating.	1	3	7	4	1

8. In your view, what formal qualifications in addition to financial competence, if any, do AC members, or at least some of them, need to have?

9.

A. To what extent do you agree with the following statement? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree), adding comments, if any:*

	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
The degree of effectiveness of an AC is influenced by the degree of independence of its members.	0	0	0	3	13

B. As regards to the Listing Rule requirement that the majority of members are to be independent, in your view:

- i. Is this an appropriate requirement?
- ii. Is such a requirement sufficiently complied with if:
  - a. Such members are not in any way involved in management nor are they directly or indirectly related to the company and/or its other board members and/or management as customers, suppliers, or in any other business or personal capacity?
  - b. Such members have been related in any way as in (i) in the past, yet there has been an adequate cooling-off period?
- iii. Would it be an enhancement to AC member independence if, in addition to the current practices in (b), AC members have to declare that they are not, nor will they be, controlled or otherwise unduly influenced by any other non-member?

**Section 3 – Authority and Resources of the Audit Committee**

10. As regards to the Listing Rule requirement that the AC is to recommend an external auditor to the Board and oversee their independence, in your opinion has such requirement reduced the practical impact of management association in the process?
11. As regards the Listing Rule requirement that the AC monitors the financial reporting process:
- A. In your opinion, is it more effective to have a separate financial reporting committee of the Board examining all financial reports prior to such AC oversight?
  - B. In your experience, are such separate financial reporting committees a common feature in Malta?
12. Given that a number of listed companies are developing their risk management oversight function:
- A. In your opinion, is it more effective for such an oversight function to be also carried out by the AC itself?
  - B. In your view, are such joint oversight functions of the AC a common feature in Malta?
13. ACs are typically authorised by their terms of reference to have unrestricted access to any information, staff and management of the company.
- A. In your view, is such unrestricted access invariably beneficial?
  - B. Would you extend such access towards the possibility for ACs to engage at their discretion:
    - i. The company's professional advisors (e.g. lawyer, architect, etc.)?
    - ii. External professional advisors?

- C. On a scale from 0 to 4, in your view are the resources of ACs in MLCs generally sufficient to ensure their effectiveness (*0 being not sufficient at all and 4 being highly sufficient*).

	Number of Interviewees = 16				
	Not Sufficient at All	Not Sufficient	Neutral	Sufficient	Highly Sufficient
Resources of ACs in MLCs are generally sufficient to ensure their effectiveness.	0	0	6	5	5

#### **Section 4 – Diligence of the Audit committee**

14. The Listing Rules specify that the AC shall meet at least four times annually.
- A. In your opinion is it appropriate for the law to stipulate a minimum number of meetings?
- B. If so, do you believe that four is an appropriate amount?
- C. On a scale from 0 to 4, do you agree that the number of meetings typically held by ACs in MLCs are sufficient for them to achieve their objectives (*with 0 being strongly disagree and 4 strongly agree*).

	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
The number of meetings typically held by ACs in MLCs are sufficient for them to achieve their objectives.	0	0	3	10	3

15. To what extent do you agree with the following statements? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree), adding comments, if any:*

	Number of Interviewees = 16				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
A. The degree of effectiveness of an AC is influenced by the frequency of the AC meetings.	0	0	5	7	4
B. <b>Problems which could arise from not having regular AC meetings include:</b>					
i. Unsolved financial reporting problems	0	1	3	6	6
ii. Increased number of restatements	0	1	8	2	5
iii. Greater likelihood of fraud	0	3	6	6	1

16. As already stated, external auditors are typically regular participants in AC meetings. Two other regular participants are normally the financial controller and the internal auditor.

- A. Do you agree with such participants being regular and only subject to exceptional absences at the discretion of the AC?
- B. Are there any other participants that you would consider to be needed as regular?
- C. If you find the regular participation stated in (a) as not acceptable, what alternative/s would you propose?

### **Section 5 – Internal Audit Contribution**

17. Wherever an internal audit function (IAF) is active in listed companies, links are typically established between such function and the AC.

- A. In your view, can an AC achieve its objectives without the contribution of an IAF?
- B. On a scale from 0 to 4, how effective would you consider the typical internal audit function contribution to MLC audit committees (*with 0 being highly ineffective and 4 being highly effective*).

	Number of Interviewees = 16				
	Highly Ineffective	Ineffective	Neutral	Effective	Highly Effective
The typical internal audit-audit committee relationship in MLCs	0	0	1	9	6

### **Section 6 – Assessment of the audit committee**

18. To what extent do you agree with the following statements? *Please rate from 0 to 4 (with 0 being strongly disagree and 4 strongly agree), adding comments, if any:*

	Number of respondents = 14				
	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
i. In my experience, Maltese ACs regularly assess their own performance.	0	5	3	3	3
ii. Where assessment is carried out, this includes the quality of communications with Boards and external auditors.	0	3	3	5	3

19. Maltese law leaves the method of assessment and evaluation of the AC up to the discretion of the Board and the AC itself and thus many times it is a form of self-assessment. In your opinion, is such assessment optimal if it is carried out:

- A. On a self-assessment basis?
- B. By the other members of the Board?
- C. By the chairman of the Board?
- D. By an independent qualified consultant?
- E. By the Board after receiving the report of an independent qualified consultant?
- F. By the annual general meeting after receiving the report of an independent qualified consultant?
- G. By shareholders' panel after receiving the report of an independent qualified consultant?
- H. Others, please specify

### **Section 7 – Overall Effectiveness of Audit Committees**

20. In your view, on a scale from 0 to 100, how effective are ACs in Malta (*with 0 being not effective at all and 100 being highly effective*)?

**Section A1 – Respondent Characteristics**

C1. Position of respondent within the firm: \_\_\_\_\_

C2. Total number of audit committee members:

Number of Members	Number of respondents = 8
	Responses
3	5
4	2
5	1
>5	-

C3. Number of males and females on the audit committee:

Gender of AC Members	Number of respondents = 8
	Number of Members
Male	24
Female	4
<b>Total number of AC members</b>	<b>28</b>

C4. Professional qualifications of audit committee members:

Qualification	Number of respondents = 8
	Number of Members
Accountancy	11
Economics	1
Management	2
Insurance	2
Banking and/or Investment	3
Law	2
Other	7
<b>Total number of AC members</b>	<b>28</b>

C5. Number of audit committee members that are:

Independence of Members	Number of respondents = 8
	Number of Members
Non-executive directors	4
Independent <sup>133</sup> non-executive directors	24
<b>Total number of AC members</b>	<b>28</b>

C6. Number of audit committee meetings each year:

Number of Meetings	Number of respondents = 8
	Responses
4	-
5	1
6	4
>6	3
<b>Mean</b>	<b>6.63</b>

C7. Is there a separate financial reporting committee within the firm?

Separate Financial Reporting Committee	Number of respondents = 8
	Responses
Yes	-
No	8

C8. Is there a risk management committee within the firm?

Risk Management Committee	Number of respondents = 8
	Responses
Yes	5
No	3

<sup>133</sup> Vide Section A2 p.A3.1-15

## **Section A2 – Definitions and Likert Scale**

### **1. Definitions**

#### **1.1 Audit Committee**

A committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer. (SOX 2002, sec. 2, par. 3A)

#### **1.2 Independent Director**

A Director shall be considered independent only if he is free of any business, family, or other relationship with the Issuer, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgement. (Listing Rules 2019, sec. 5.119)

### **2. Agreement Scale**

0	1	2	3	4
<b>Strongly Disagree</b>	<b>Disagree</b>	<b>Neutral</b>	<b>Agree</b>	<b>Strongly Agree</b>

## Appendix 3.2 Statistical Data Analysis using the Friedman Test

The Friedman Test was used to compare the mean rating scores provided to a number of related statements in each of the Likert scale questions. These mean rating scores range from 0 to 4, where 0 corresponds to 'Strongly Disagree' / 'Not Sufficient at All' / 'Highly Ineffective' and 4 corresponds to 'Strongly Agree' / 'Highly Sufficient' / 'Highly Effective'. Therefore, the larger the mean rating score, the higher the agreement/sufficiency/effectiveness.

The **null hypothesis** ( $H_0$ ) specifies that the mean rating scores provided to the statements vary marginally and is accepted if the  $p$ -value exceeds 0.05 level of significance.

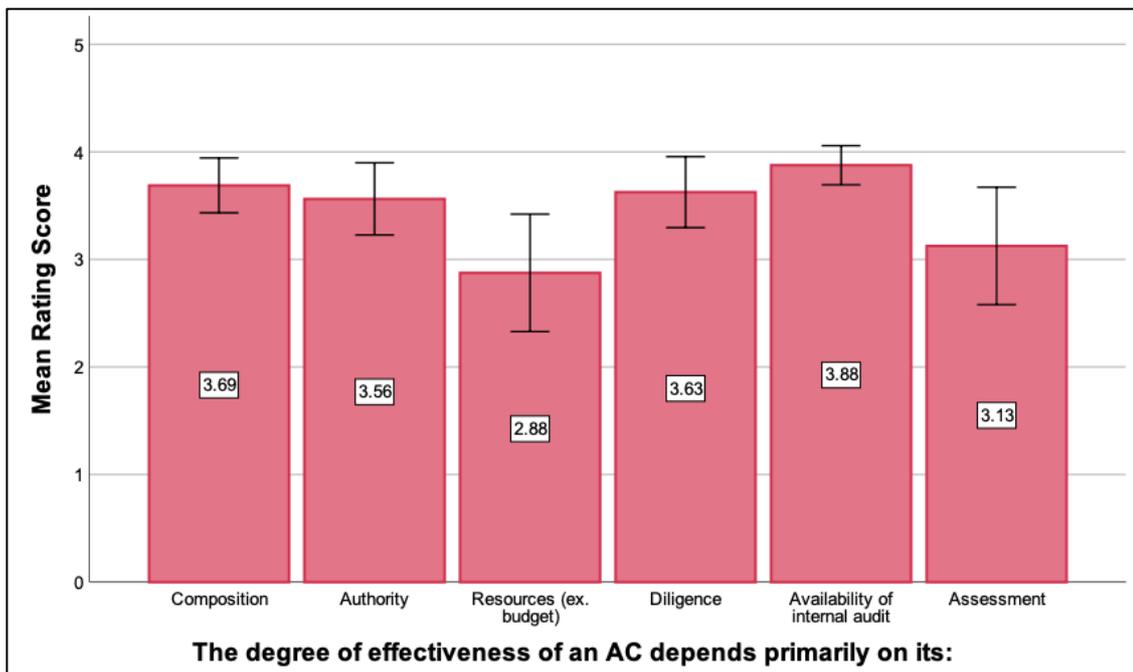
The **alternative hypothesis** ( $H_1$ ) specifies that the mean rating scores provided to the statements vary significantly and is accepted if the  $p$ -value is less than the 0.05 criterion.

The bar graphs presented in this appendix supplement the statistical tables presented in Chapter Four. Such bar graphs visually depict the disparities, significant or otherwise, between the level of agreement with each statement in the Likert scale questions and clearly portray the results of the Friedman Test.

The error bar graph displays the 95% confidence interval of the actual mean rating score provided to a statement if the whole population of internal auditors, CFOs, external auditors and regulators had to be included in the study. If two confidence intervals overlap, this indicates that their mean rating scores are similar and do not differ significantly. Conversely, when two confidence intervals do not overlap, this indicates that their mean rating scores differ significantly.

### **Section 1: Determinants of Audit Committee Effectiveness**

Figure A3.1 below presents the interviewees' level of agreement with the primary components of ACE. As can be seen, the error bar of statement (i) does not overlap the error bar of statement (iii) and the error bar of statement (v) does not overlap those of statements (iii) and (vi). This indicates that the mean rating scores provided to such statements vary significantly as confirmed by the  $p$ -value of 0.000.



*Figure A3.1: Primary Components of ACE (Qn. 1)*

## Section 2: Composition of the Audit Committee

Figure A3.2 below presents the interviewees' level of agreement with how an AC chairperson needs to be appointed. As can be seen, the error bar of statement (i) overlaps marginally that of statement (ii) and does not overlap the error bar of statement (iii). This indicates that the mean rating scores provided to such statements vary significantly as confirmed by the  $p$ -value of 0.037.

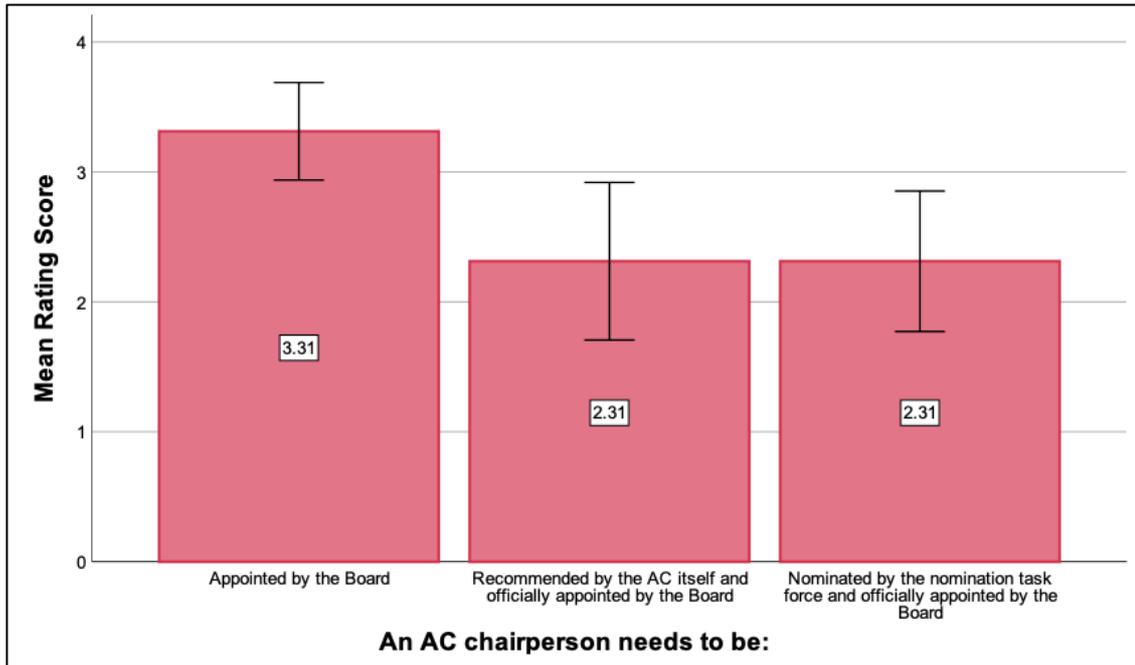


Figure A3.2: Appointment of AC Chairperson (Qn.2A)

Figure A3.3 below presents the interviewees' level of agreement with the likely benefits of smaller ACs. As can be seen, the error bars are overlapping, indicating that the mean rating scores provided to such statements do not differ significantly. This is confirmed by the  $p$ -value of 0.162.

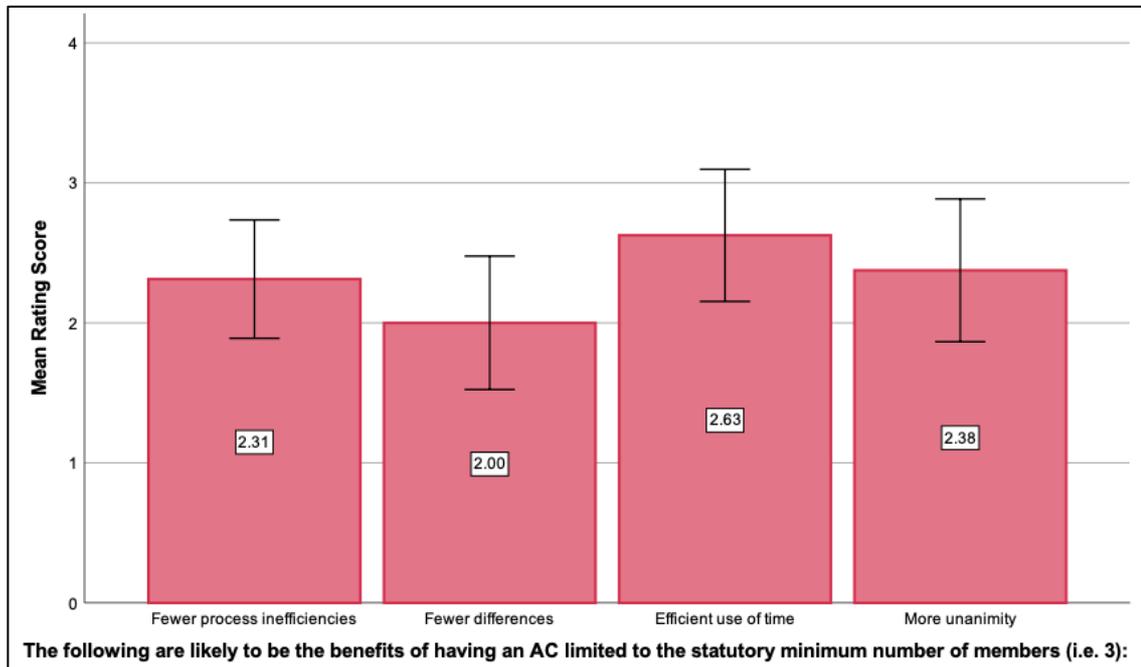


Figure A3.3: Benefits of Smaller ACs (Qn.3)

Figure A3.4 below presents the interviewees' level of agreement with likely benefits of larger ACs. As can be seen, the error bar of statement (ii) does not overlap that of statement (i) and statement (iii). This indicates that the mean rating scores provided to such statements vary significantly as confirmed by the  $p$ -value of 0.000.

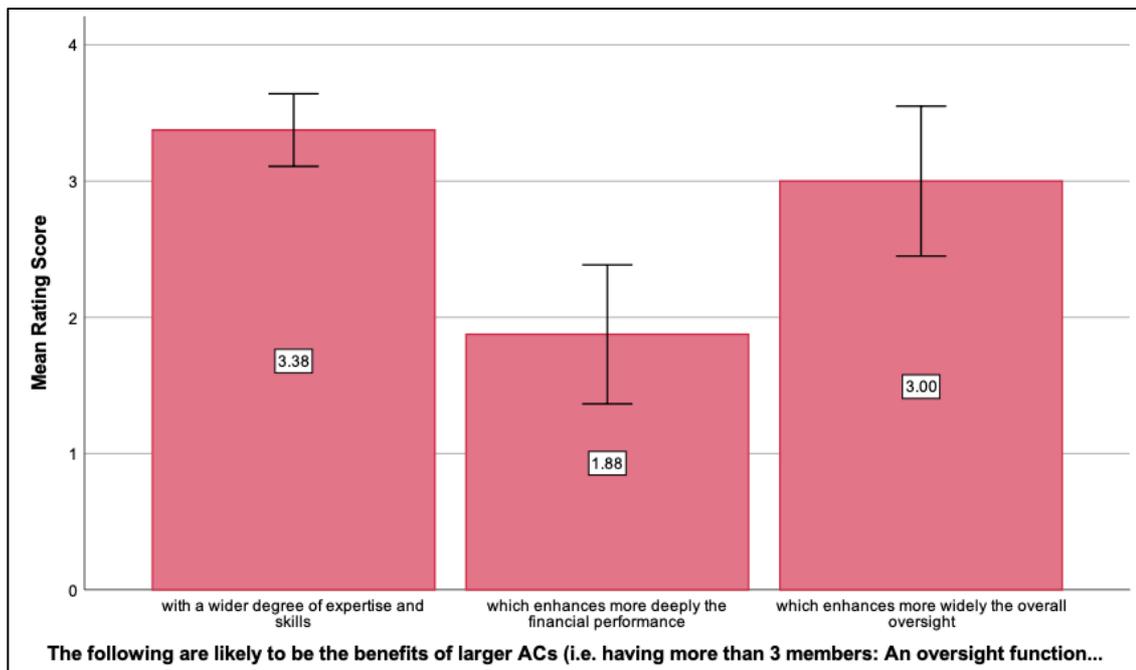


Figure A3.4: Benefits of Larger ACs (Qn.4)

Figure A3.5 below presents the interviewees' level of agreement with the required and actual competences of AC members. As can be seen, the error bar of statement (A1) does not overlap that of statement (A2). This indicates that the mean rating scores provided to such statements vary significantly as confirmed by the  $p$ -value of 0.000. Conversely, the error bars of statements (B1) and (B2) overlap, indicating that their mean rating scores do not vary significantly. This is confirmed by the  $p$ -value of 0.414.

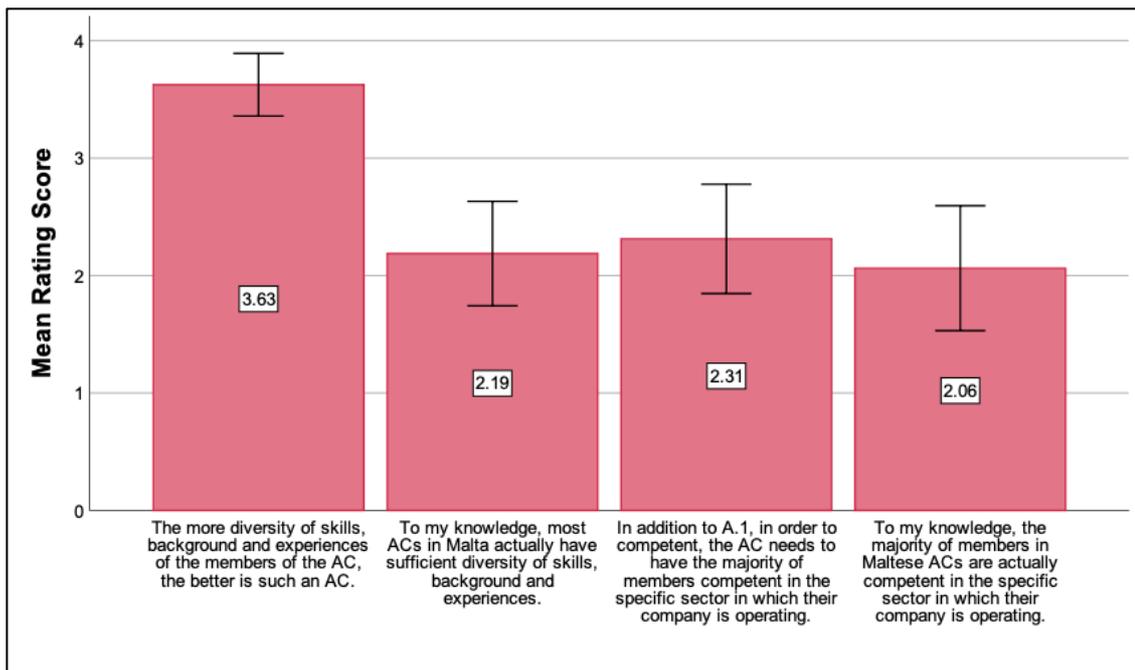


Figure A3.5: Required and Actual Competences of AC Members (Qn.7)

**Section 4: Diligence of the Audit Committee**

Figure A3.6 below presents the interviewees' level of agreement with problems that could arise due to insufficient AC meetings. As can be seen, the error bars are overlapping, indicating that the mean rating scores provided to such statements do not differ significantly. This is confirmed by the  $p$ -value of 0.078.

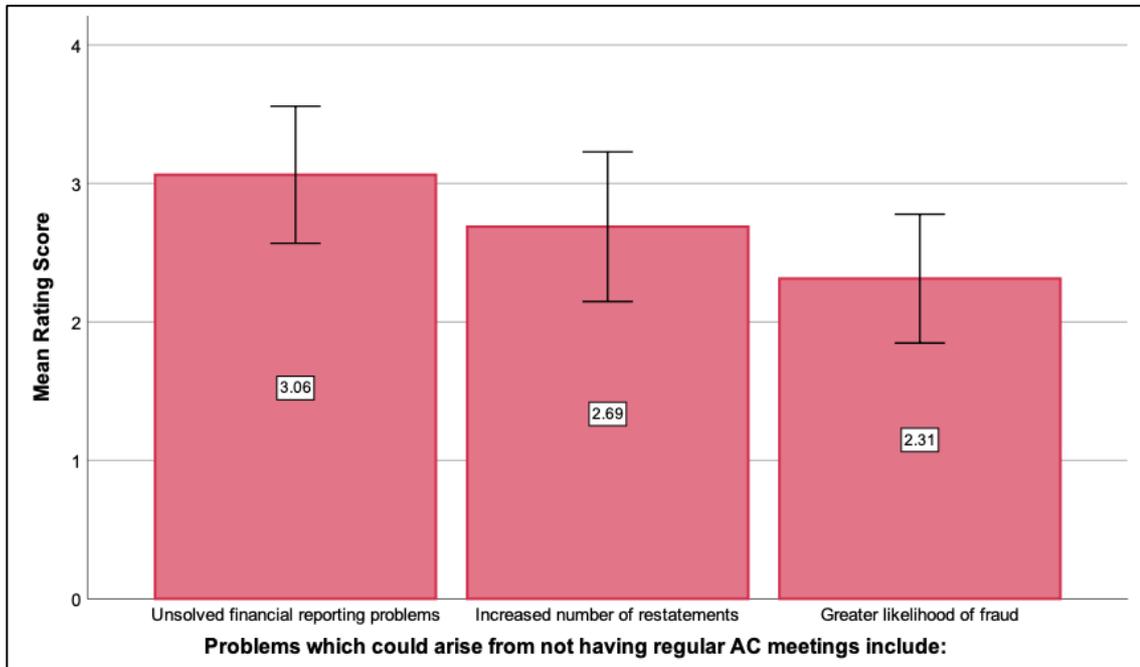


Figure A3.6: Problems due to Irregular AC Meetings (Qn.15B)

**Section 6: Assessment of the Audit Committee**

Figure A3.7 below presents the interviewees' level of agreement with the occurrence and level of self-assessment in MLC ACs. As can be seen, the error bars are overlapping, indicating that the mean rating scores provided to such statements do not differ significantly. This is confirmed by the  $p$ -value of 0.180.

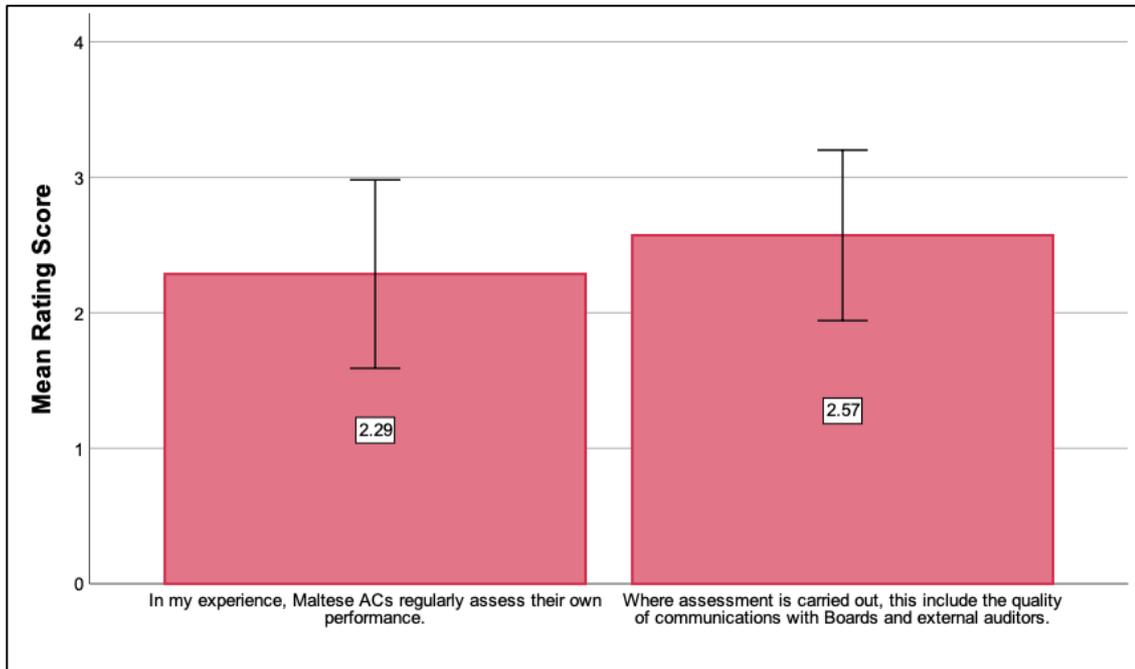


Figure A3.7: Self-Assessment within ACs of MLCs (Qn. 18)

## Appendix 3.3 Statistical Data Analysis using the Mann-Whitney Test

The Mann Whitney test was used to compare mean rating scores provided to a statement between two independent groups. These mean rating scores range from 0 to 4, where 0 corresponds to 'Strongly Disagree' / 'Not Sufficient at All' and 4 corresponds to 'Strongly Agree' / 'Highly Sufficient'.

Since only two representatives from the regulators participated in this research study, these representatives and the audit firm representatives were treated as a single group for the purpose of this test. The MLC representatives were treated as another group.

The **null-hypothesis** ( $H_0$ ) specifies that the mean rating scores provided to the statements vary marginally between the two groups and is accepted if the  $p$ -value exceeds the 0.05 level of significance.

The **alternative hypothesis** ( $H_1$ ) specifies that the mean rating scores provided to the statements vary significantly between the two groups and is accepted if the  $p$ -value is less than the 0.05 criterion.

### ***Mann-Whitney Test 1: Appointment of the Audit Committee Chairperson***

The Mann-Whitney test was used to analyse whether the mean rating scores provided to the statements relating to the appointment of the AC chairperson differ significantly between MLC representatives and audit firm representatives along with the regulators.

<b>An AC chairperson needs to be:</b>	<b>Group</b>	<b>Mean</b>	<b>St. Dev</b>	<b><i>p</i>-value</b>
i. Appointed by the Board	MLC representatives	3.50	0.527	0.235
	EAs/Regulators	3.00	0.894	
ii. Recommended by the AC itself and officially appointed by the Board	MLC representatives	2.00	1.247	0.110
	EAs/Regulators	2.83	0.753	
iii. Nominated by the nomination task force and officially appointed by the Board	MLC representatives	1.90	0.738	0.037
	EAs/Regulators	3.00	1.095	

*Table A3.1: Process of Appointing an AC Chairperson (Qn.2.A)*

Table A3.1 shows that the mean rating score for statement (iii) '*Nominated by the nomination task force and officially appointed by the Board*' varies significantly between the two groups since the *p*-value is less than the 0.05 level of significance. Therefore, the alternative hypothesis is accepted. In the other two statements, (i) and (ii), the mean rating scores do not differ significantly between the two groups as the *p*-value is higher than the 0.05 criterion. Thus, the null hypothesis is accepted.

### ***Mann-Whitney Test 2: Statements Related to Competencies of Audit Committee Members***

The Mann-Whitney test was used to analyse whether the mean rating scores provided to the statements relating to the competencies of AC members differ significantly between MLC representatives and audit firm representatives along with the regulators.

<b>Statement</b>	<b>Group</b>	<b>Mean</b>	<b>St. Dev</b>	<b>p-value</b>
A.1. The more diversity of skills, background and experiences of the members of the AC, the better such an AC.	MLC representatives	3.70	0.483	0.439
	EAs/Regulators	3.50	0.548	
A.2. To my knowledge, most ACs in Malta actually have sufficient diversity of skills, background and experiences.	MLC representatives	2.50	0.850	0.046
	EAs/Regulators	1.67	0.516	
B.1. In addition to A.1, in order to be competent, the AC needs to have the majority of members competent in the specific sector in which the company is operating.	MLC representatives	2.30	0.949	0.952
	EAs/Regulators	2.33	0.816	
B.2. To my knowledge, the majority of members in Maltese ACs are actually competent in the specific sector in which the company is operating.	MLC representatives	2.30	0.949	0.277
	EAs/Regulators	1.67	1.033	

*Table A3.2: Competencies of AC Members (Qn.7)*

Table A3.2 shows that the mean rating score for statement (iv) '*In my view, most ACs in Malta have sufficient diversity of skills, background and experience*' varies significantly between the two groups since the  $p$ -value is less than the 0.05 level of significance. Therefore, the alternative hypothesis is accepted. In the other statements, (i), (ii) and (iii), the mean rating scores do not differ significantly between the two groups as the  $p$ -value is higher than the 0.05 criterion. Thus, the null hypothesis is accepted.

### ***Mann-Whitney Test 3: Statement Related to Resources of Maltese Audit Committees***

The Mann-Whitney test was used to analyse whether the mean rating scores provided to the statements relating to the sufficiency of resources of MLC's ACs differ significantly between MLC representatives and audit firm representatives along with the regulators.

<b>Statement</b>	<b>Group</b>	<b>Mean</b>	<b>St. Dev</b>	<b>p-value</b>
In your view are the resources of ACs in MLCs generally sufficient to ensure their effectiveness?	MLC representatives	3.30	0.675	0.025
	EAs/Regulators	2.33	0.816	

*Table A3.3: Sufficiency of the Resources of MLC's ACs (Qn.13.C)*

Table A3.3 shows that the mean rating score for the question '*In your view are the resources of ACs in MLCs generally sufficient to ensure their effectiveness*' varies significantly between the two groups since the *p*-value is less than the 0.05 level of significance. Therefore, the alternative hypothesis is accepted.

### ***Mann-Whitney Test 4: Statements Related to the Frequency of Audit Committee Meetings***

The Mann-Whitney test was used to analyse whether the mean rating scores provided to the statements relating to the frequency of AC meetings and problems which could arise from the lack thereof, differ significantly between MLC representatives and audit firm representatives along with the regulators.

<b>Statement</b>	<b>Group</b>	<b>Mean</b>	<b>St. Dev</b>	<b>p-value</b>
A. The degree of effectiveness of an AC is influenced by the frequency of the AC meetings	MLC representatives	3.30	0.675	0.015
	EAs/Regulators	2.33	0.516	
<b>B. Problems which could arise from not having regular AC meetings include:</b>				
i. Unsolved financial reporting problems	MLC representatives	2.90	1.101	0.491
	EAs/Regulators	3.33	0.516	
ii. Increased number of restatements	MLC representatives	2.50	1.080	0.288
	EAs/Regulators	3.00	0.894	
iii. Greater likelihood of fraud	MLC representatives	1.90	0.738	0.014
	EAs/Regulators	3.00	0.632	

*Table A3.4: Frequency of AC Meetings (Qn.15)*

Table A3.4 shows that the mean rating score for statements (A) ‘*The degree of effectiveness of an AC is influenced by the frequency of the AC meetings*’ and (B.iii) ‘*Greater likelihood of fraud*’ vary significantly between the two groups since the *p*-value is less than the 0.05 level of significance. Therefore, the alternative

hypothesis is accepted. In the other statements, (B.i) and (B.ii), the mean rating scores do not differ significantly between the two groups as the  $p$ -value is higher than the 0.05 criterion. Thus, the null hypothesis is accepted.

## Appendix 3.4 Statistical Data Analysis using the Spearman Test

The Spearman correlation coefficient measures the strength of the relationship between two variables having an ordinal scale and it ranges from -1 to 1. A coefficient close to 1 indicates a strong positive relationship, a coefficient close to -1 indicates a strong negative relationship and a coefficient close to 0 indicates no relationship between the two variables.

The **null hypothesis** ( $H_0$ ) specifies that there is no relationship between the two variables and is accepted if the  $p$ -value exceeds the 0.05 level of significance.

The **alternative hypothesis** ( $H_1$ ) specifies that there is a significant relationship between the two variables and is accepted if the  $p$ -value is less than the 0.05 criterion.

The Spearman test was used to measure the strength of the relationship between a selected number of closed-ended questions and the last question (Qn.20) of the interview schedule, 'In your view, on a scale from 0 to 100, how effective are ACs in Malta?'

Relation with Qn.20	Mean	Spearman Correlation	P-value
Qn.17.B – Internal Audit Contribution	3.31	0.155	0.567
Qn.14.C – Diligence	3.00	0.023	0.931
Qn.13.C – Authority and Resources	2.94	<b>0.650</b>	<b>0.006*</b>
Qn.15.A – Diligence	2.94	0.461	0.073
Qn.18.ii – Assessment	2.57	0.119	0.684
Qn.5.A – Composition	2.31	0.227	0.397
Qn.18.i – Assessment	2.29	0.174	0.551
Qn.7.A.2 – Composition	2.19	0.185	0.492
Qn.7.B.2 – Composition	2.06	0.408	0.117
<b>Average Mean Rating Score</b>	<b>2.63</b>	<b>Friedman Test:</b> $\chi^2(1) = 1.000, p = 0.317$	
<b>Mean Rating Score of Qn.20</b>	<b>2.90</b>		

Table A3.5: Strength of Relationship with Qn.20

The final question (Qn.20) which had a scale from 0 to 100, was rescaled to have a scale from 0 to 4, where 0 corresponds to 'Highly Ineffective' and 4 corresponds to 'Highly Effective' simply by dividing the values by 25.

The mean rating scores provided to Qn.20 are positive and significantly related with the mean rating scores provided to Qn.13.C 'In your view are the resources of ACs in MLCs generally sufficient to ensure their effectiveness?' since the  $p$ -value is less than the 0.05 level of significance. Therefore, the alternative hypothesis was accepted. However, for the remaining statements the relationship was not significant since the  $p$ -values exceeded the 0.05 criterion. Thus, the null hypothesis was accepted.

It should be noted that the  $p$ -value depends heavily on the sample size and it is very unlikely to get statistical significance when the sample size is small ( $>20$ ) unless the relationship is exceptionally strong.

Moreover, the average mean rating score of the individual questions and the mean rating score of Qn.20 do not differ significantly since the  $p$ -value, derived from the Friedman Test, is more than the 0.05 level of significance ( $p=0.317$ ).