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

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Abstract:

Purpose: In this study we assess and analyse the effectiveness of Audit Committees within Maltese Listed Companies with respect to the following five determinants: composition, authority and resources, diligence, internal audit contribution and assessment.

Design/Methodology/Approach: 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 Maltese Listed Companies representatives, four External Auditors and two Regulators.

Findings: The findings indicate that there is still some disagreement as to the extent of Maltese Audit Committee Effectiveness. The appointment of Audit Committee members is left to the discretion of the Board, which tends to appoint the Non-Executive Director to the Audit Committees without sufficient considerations for their competences and possibly their effective independence. Additionally, Audit Committees might be over-burdened with extremely varied objectives and with insufficient resources for them to reach all such objectives.

Practical Implications: Audit Committee meetings held by Maltese Listed Companies seem to surpass the minimum requirement stipulated by law and this is perceived to be contributing to their effectiveness. Moreover, although Internal Audit Functions are seen as fundamental for Audit Committees to reach their objectives, the lack of a statutory requirement to establish IAFs is probably negatively impacting Audit Committee Effectiveness.

Originality/value: Finally, although there seems to be a general opinion that Audit Committees 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.

Keywords: Audit Committees, Audit Committee Effectiveness, Effectiveness Determinants.

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1. Introduction

The audit committee (AC) is an integral and essential part of the corporate governance (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).

The primary aim of this study is to assess and analyse the effectiveness of ACs within Maltese Listed Companies (MLCs). To achieve this, this study assessed the effectiveness of Maltese ACs with respect to the following determinants, composition, authority and resources, diligence, internal audit contribution and assessment. Although, this study is conducted in Malta, a small island state in the European Union, similarly to various authors such as Bezzina *et al.* (2012; 2014), Briguglio (1995), King (1993) have used islands as small scale laboratories for more complex politics, regulations and policies of larger countries. It sheds light on the somewhat ambiguous perceptions that seem to prevail regarding the effectiveness of Maltese ACs. It also puts forward relevant recommendations to assist companies in deriving more value from their ACs and to prompt regulatory authorities to specify additional guidance in certain areas.

2. Literature Review

2.1 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 *et al.* (2002) defined Audit Committee Effectiveness (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.*“

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). 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), 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. 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). 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 (ACI, 2017). As such, the assessment of the AC is also considered to be a determinant of ACE.

2.2 Composition

Bromilow and Keller (2011) argue that the degree of ACE depends primarily on the structure and communication between its members.

2.2.1 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 Non-Executive Directors (NED)s 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 often 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.

2.2.2 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.

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 and 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).

2.2.3 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) 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 External Auditor (EA) (Mangena and 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.

2.2.4 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. 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) 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.

2.3 Authority and Resources

The authority of the AC is essentially a result of its “*responsibilities and influence*” (DeZoort *et al.* 2002). 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).

2.3.1 Selection of the External Auditor

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).

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 Lookninan-Brown (2011) who found that an EA previously affiliated with management was more likely to be chosen by the AC.

2.3.2 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). 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). 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 and 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). If any part of the financial reporting process fails to satisfy the AC, then it should report this to the Board (FRC, 2016).

2.3.3 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).

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).

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 *et al.*, 2019).

2.3.4 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.

2.4 Diligence

Diligence is the process by which ACE may be achieved. Kalbers and Fogarty (1993) 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). The Maltese Listing Rules 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). In fact, Braiotta *et al.* (2010) states that management should not be present at the AC meetings.

As the number of meetings increases, the oversight function becomes more effective and the financial performance is enhanced (Aldamen *et al.*, 2012). All in all, more frequent AC meetings enhance financial reporting adequacy and external audit quality (DeZoort *et al.* 2002).

2.5 Internal Audit Contribution

Internal Audit Functions (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 and 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).

2.6 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.

3. Research Methodology

3.1 The 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). 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 and 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 quantitatively. Moreover, the unique structure of the SSI allows it to be employed in mixed-method research (Mcintosh and Morse, 2015).

The interview schedule developed for this research study consists of seven sections and was targeted at internal auditors (IAs), chief financial officers (CFOs) and external auditors (EAs) of MLCs as well as the local regulators of ACs. The interview schedule consisted of a combination of both closed-ended and open-ended questions. A five-point Likert Scale, with '0' being strongly disagree/not sufficient at all/highly ineffective and '4' being strongly agree/highly sufficient/ highly effective was employed for the closed-ended questions.

3.2 The Sample Population

For the purpose of this study a list of all equity-listed companies on the Malta Stock Exchange (MSE) was obtained from the MSE website. Ten (10) interviews were

conducted with representatives of MLCs comprising mainly of heads of internal audit (IA) and one CFO (C) and four (4) 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 (2) 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. Interviews were stopped as saturation was reached and no further value could be added by another interview.

3.3 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 using the thematic analysis approach (Braun and Clarke, 2006). The Friedman Test 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 was then employed to compare the mean rating scores provided by the different groups of interviewees and to identify any disparities between their responses. Furthermore, the Spearman Test was used to analyse the strength of the relationship between selected questions and the last question of the interview schedule.

4. Findings And Discussion

4.1 Determinants of Audit Committee Effectiveness

Interviewees were asked to rate their agreement with six determinants extracted from the literature upon which factors the AC degree of effectiveness may depend.

4.1.1 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 audit committee effectiveness (ACE). Nonetheless, although also agreeing to such availability, one Regulator cautioned that even with this, the AC is not rendered "bulletproof".

4.1.2 The Composition of Acs

Interviewees strongly agreed ($\bar{x}=3.69$) that the composition of ACs is another determinant. Two IAs (internal auditors) 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.

4.1.3 The Diligence of Acs

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

4.1.4 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 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 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.

4.1.5 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 noted that third parties are to be involved in carrying out such assessments.

4.1.6 The Resources of ACs

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

4.2 Composition

4.2.1 Appointment of Audit Committee Chairperson

Respondents were provided with three statements on how an AC chairperson needs to be appointed and asked to rate their agreement with each one.

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 explained that the vetting to become a director in an MLC is ever increasing, thus the Board undoubtedly has the capacity and experience to appoint an appropriate AC chairperson. One IA 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 argued that AC members need to have a say in the decision. However, slightly more interviewees 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 (7/16) 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 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.

Interviewees were then asked for their view on common practices in Malta with respect to the appointment of the AC chairperson. Interviewees clarified that in Malta it is the Board, which commonly appoints the AC chairperson. Two EAs 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). One IA qualified this, stating that this depends on whether such a person is independent besides being competent.

4.2.2 Minimum Number of Audit Committee Members

Interviewees were then asked to rate their agreement as to whether the degree of ACE is influenced by the size of the AC. Interviewees were neutral ($\bar{x}=2.31$) on this. One Regulator, upon agreeing, added that if ACs become too large, there is a danger that meetings would easily be “paralysed”. Interviewees were then asked whether they think that the minimum number of three members stipulated by Maltese law is appropriate. Most agreed to this. Two IAs added that “three suffice, more is a crowd, only amplifying the challenges of reaching a consensus”. Two interviewees argued that such minimum varies with the needs of the MLC. One Regulator 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 whether they think that a maximum threshold needs to be established by law. Eleven respondents 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 and ultimately it depends on the time the AC members have to give to the AC itself. Five agreed to have a maximum set by law setting such maximum as five, six or seven members.

4.2.3 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). In this context, respondents were first asked what they consider to be a sufficient level of competence in accounting and/or auditing. Twelve comments referred to the requirement that the member at least needs to be a CPA. Moreover, other comments referred to a minimum requirement of ten years' experience in the field of accounting/auditing, preferably in the company's same industry. Three comments also referred to the need for members to keep abreast of current developments in the industry.

Secondly, interviewees were asked whether they believe that having accounting/auditing expertise is essential for the proper functioning of ACs. Interviewees agreed, with six arguing, in line with BRC (1999), that financial statements have become so complex that such expertise is a sine qua non. Furthermore, four added that such competence does not have to be held by the chairperson.

4.2.4 Other Competencies of Audit Committee Members

Respondents were provided with four statements concerning the AC members' required and actual competencies and asked to rate their agreement. The four statements were presented in two parts. In the first part, two statements were presented on the required and actual diversity of skills, background and experiences of AC members while, in the second part, two other statements were presented on the required and actual competencies of AC members in the specific sector in which the company is operating.

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 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. Two EAs explained that, although ACs have improved, more diversity of skills is required. Additionally, one Regulator 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 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). One EA argued

that this is essential, explaining that otherwise effective contribution would not be possible.

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 explained that only some members are competent in the sector. One EA agreed that the majority are competent in the sector but to different degrees.

4.2.5 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. Given this, ascertaining whether from all the respondents' perspective AC members' independence influences ACE is clearly relevant. In this connection, interviewees were asked to rate their agreement as to whether ACE is influenced by the degree of AC members' independence. Respondents strongly agreed ($\bar{x}=3.81$) to this statement. Three argued that this is imperative, as nothing is achieved if they are or even seen to be as "management's puppets". However, one IA 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.

A further question asked respondents whether the Listing Rule requirement that the majority of AC members are to be independent is appropriate. Respondents agreed with this requirement, with two interviewees (2/16) adding that this was essential if AC members are to have a clear mindset to challenge management. Two interviewees 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 asked whether it would be an enhancement to AC member independence if, in addition to the current practices AC members have to declare that they are not, nor will they be, controlled or otherwise unduly influenced by any other non-member. Twelve interviewees stated that the requirement for such a declaration would be an enhancement. One 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 claimed that such a declaration does not in itself add any comfort to shareholders.

4.3 Authority and Resources

4.3.1 Appointment and Oversight of External Auditors

Interviewees were asked 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

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 Lookninan-Brown's (2011) findings who found no such reduction. Three added that in view of the tendering process overseen by the AC, management can no longer select the EA behind closed doors. One IA 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 disagreed that management association has been reduced. Five 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.

4.3.2 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. 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 whether it is more effective to have such a separate Committee examining all financial reports prior to ACs.

Eleven interviewees argued against having a separate Financial Reporting Committee. Most commonly, respondents indicated that having properly structured ACs with more members competent in accounting/auditing would eliminate any need for such a Committee. Moreover, another subscribed opinion was that the introduction of another committee would be too cumbersome for many companies and might overlap with the respective AC. Two 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). Three respondents stated that this depends on the company's resources and size. Contrastingly, another two agreed that such a separate Committee is needed as such a Committee adds to the robustness of the financial reporting process and ACs too often end up "overloaded", with very long meetings that fail to meet their objectives.

Furthermore, interviewees were asked whether such separate Financial Reporting Committees are actually common in Malta. Respondents stated that in their experience, such committees are not a common feature.

4.3.3 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. 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 whether, in their opinion, ACs should also carry out risk management oversight, even though several MLCs are developing a separate risk management oversight function.

Six interviewees agreed that it would be more effective if ACs also carry out risk management oversight. Four 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 stated that having an Audit and Risk Committee would reduce the risk of duplication or of overlooking important issues. However, five interviewees opposed the idea of having one joint committee. Three emphasised that under the Enterprise Risk Management Framework, “risk forms part of the 2nd line of defence, while audit part of the 3rd”. Two remarked that risk requirements have increased drastically, and therefore, it is essential to have a specific RM committee. Five interviewees argued that whether the two fall under one committee or not depends on three factors: the AC members’ competencies in risk, whether the industry is regulated or not and on the competences of the RM unit.

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

4.3.4 Right to Unrestricted Access

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

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

Furthermore, interviewees were asked to rate, whether in their experience, ACs in MLCs generally have sufficient resources to ensure their effectiveness. Interviewees agreed ($\bar{x}=2.94$) that generally AC resources are sufficient, with five adding that there still remains room for improvement. Six 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.

4.4 Diligence

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. These three questions relating to the frequency and regularity of meetings may provide further insights on the MLC situation.

4.4.1 Audit Committee Meeting

Interviewees were asked whether, in their opinion, it is appropriate for the law to stipulate a minimum number of AC meetings. Most agreed, stating this ensures effectiveness. Four insisted that it is imperative that companies do not interpret this to meet four times only. One respondent disagreed with a 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 whether four is appropriate. Ten respondents agreed that once quarterly is normally enough but this varies with different companies. Five 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 to rate their agreement with whether the meetings held, on average, by ACs in MLCs are sufficient to achieve their objectives. Respondents agreed ($\bar{x}=3.00$) that the number of meetings typically held by ACs in MLCs are sufficient. One agreeing EA remarked that some ACs hold more than four meetings when the need arises. Conversely, three interviewees 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.

4.4.2 Audit Committee Meetings and Effectiveness

Does the Frequency of AC Meetings Influence ACE?

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. One IA upon agreeing, added that meeting frequently is essential to keep in touch with and add value to the organisation. Conversely, five respondents 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).

4.4.3 Regular Participants in Audit Committee Meetings

Interviewees were asked whether they agree to having the EAs, IAs and the financial controller as regular participants in AC meetings. Twelve agreed with their regular

participation. This is in contrast with Braiotta et al. (2010). One IA stated that however the meeting should still proceed if they do not attend. Another four disagreed to having such participants regularly in AC meetings. Two EAs upon disagreeing, argued that having the financial controller present throughout all meetings might discourage EAs from discussing certain issues. Respondents were next asked whether there are any other participants which they would consider to be regularly needed in AC meetings. Twelve interviewees commented that some other participants are needed as 'regular'. Most commonly, the CEO was named because every decision taken ultimately impacts his/her terms of reference. The CRO and COO were also mentioned as important regular participants especially if the company is regulated. The Head of IT was also mentioned especially if the AC lacks technological expertise. Conversely, four interviewees 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 whether they could propose any alternative. These stated that the mentioned participants are to be "called in meetings as necessary" depending on the agenda. Moreover, two EAs argued that meetings should commence with only the AC members and secretary, then such participants are called in in their specific time slots.

4.5 Internal Audit Contribution

Respondents were then asked whether, in their view, ACs can achieve their objectives without the contribution of the IAF. Twelve respondents emphasised that ACs "definitely cannot" achieve their objectives without the IAF. However, nine of these 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 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 to rate how effective they consider the internal audit contribution to MLC ACs. Respondents agreed that such contribution is effective ($\bar{x}=3.31$). Nine 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 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.

4.6 Assessment

4.6.1 Audit Committee Self-Assessment

Interviewees were presented with two statements and asked to rate their agreement with each one, based on their experience in the Maltese scenario.

Do Maltese ACs Carry Regular Assessment of their own Performance?

Respondents were undecided ($\bar{x}=2.29$) on this statement. Six strongly agreed or agreed to this, while most of the others disagreed, stating that this is to be carried out at Board rather than at AC level. Three 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 strongly agreed or agreed. Six 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.

4.6.2 Optimal method of audit Committee Assessment

Respondents were provided with seven alternative parties 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.

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. 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 opposed such an alternative arguing that an independent qualified consultant “increases bureaucracy” and is “the root to conflict”. Seven 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 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 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 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).

4.7 Overall Effectiveness of Audit Committees

Interviewees were finally asked to rate how effective are ACs in MLCs. Respondents agreed that ACs in MLCs are adequately effective with a mean of 72.5%. Twelve interviewees 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 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?”.

5. Discussion

5.1 Composition – Taste

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

5.1.1 Is the Appointment of the Audit Committee Chairperson to be Regulated?

Collier (1993) 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 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) 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 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 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.

5.1.2 Audit Committees-Too Large or too Small?

Although the Listing Rules specify that ACs need to be composed of at least three members, AC size remains a highly controversial aspect of AC composition.

However, the findings suggest that it is ultimately the time which AC members have at their disposal which will impact their effectiveness. Furthermore, contrary to the literature, the findings 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 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 than a 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. Rather than being prescriptive, the Rules may also permit such a range to be exceeded, subject to well-grounded justification.

5.1.3 What is Financial Competence and is this Enough?

DeZoort *et al.* (2002) 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 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), interviewees also argued that, the required expertise must be enough for AC members to fully understand ever-more-complex financial statements.

Furthermore, the corporate scandals of the 20th 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 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. 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), the findings 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.

5.1.4 Member Independence-Fact or Fiction?

As already stated earlier in this chapter and also in the literature, 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. 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). Furthermore, within the Maltese context, there is the further limitation of a small state with a limited pool of qualified persons. 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 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. 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.

5.2 Authority and Resources – Sight

AC authority is claimed by DeZoort *et al.* (2002) 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.

5.2.1 Authority-Is the Audit Committee Doing Enough?

Is AC Deciding Better than Recommending the External Auditor Appointment?

According to Dhaliwal *et al.* (2015), 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, 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 were 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), 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), 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 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), interviewees believe 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.

Are Audit Committees to Monitor Risk Management Systems?

As explained in the literature, 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. 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), 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. 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.

5.2.2 Resources – Are they Adequate?

According to DeZoort *et al.* (2002), adequate AC oversight depends on whether the AC has the necessary resources to function. The findings 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 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) advocates such improved communications if the interested parties are to undertake their responsibilities better. Moreover, further research is needed in this regard.

5.3 Diligence – Hearing

One valid proxy used to measure diligence is “*the number of AC meetings held per year*” (DeZoort *et al.* 2002). 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 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. 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.

Several authors have argued that certain problems tend to arise if insufficient meetings are held. In this regard, the findings 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. In contrast, the findings 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.

5.4 Internal Audit Contribution – Touch

According to Cadbury (1992), 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 with independent assurance. The findings 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.

5.5 Assessment – Smell

The ACI (2017) 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 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) 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 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. 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 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.

Are Audit Committees in Maltese Listed Companies Effective?

Finally, the findings seem to indicate that ACs in MLCs are adequately effective, yet there still remains room for improvement albeit the recent developments.

Table 1. Strength of Relationship with Qn.20

| 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 | 0.650 | 0.006* |
| 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 |
| Average Mean Rating Score of 9 Qns. | 2.63 | Friedman Test: $X^2(1) = 1.000, p = 0.317$ | |
| Mean Rating Score of Overall Qn. 20 | 2.90 | | |

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

4= Strongly Agree/Highly Effective/Highly Sufficient

Source: Own study.

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

6. Conclusion

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. 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.

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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