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Is Disclosure a Suitable Mechanism for Regulating Corporate Governance? Are Existing Disclosure Mechanisms Sufficient?

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ABSTRACT

The primary purpose of this article was undertaken to find out if the disclosure by standard and premium listed companies in the United Kingdom (UK) is a suitable mechanism to regulate the corporate governance of such companies. It went further to determine if the disclosure mechanisms be it mandatorily or voluntary are sufficient to regulate a company. If not, to identify remedial measures. This article thus studied the various disclosures made by standard and premium listed companies in the UK as it is, its problems and recommended other corporate governance mechanisms to support the disclosure mechanism used in regulating corporate governance so as to foster investors and potential investors confidence in investee companies.

INTRODUCTION

This article focuses on whether or not disclosure is a suitable mechanism for regulating corporate governance. In analysing this, it goes further to determine if the existing compulsory or voluntary disclosure mechanisms are sufficient to regulate corporate governance. In recent years, there has been an interest in the disclosures made by companies. This interest in disclosure grew out of the increasing prominence of corporate governance in the business world. Corporate governance as a discipline has developed steadily over the years. Its growth can be said to be an outcome of the recent global financial crisis which exposed poor corporate governance inherent in corporate and financial institutions which has had crippling effects on the whole business world. The result of these negative occurrences has put corporate governance in the focal view as the saviour which can help restore investors and potential investors' confidence in their investee company. Corporate governance enhances disclosure in corporations and this aids shareholders and other investors to properly monitor the performance of their investee companies. Also, potential investors use information disclosed to reach an informed decision on whether or not to invest in a company or companies as the case maybe. Therefore, disclosed information, if trusted, helps to build the confidence of investors and potential investors in a company.

In analysing these issues, this article seeks to answer the following questions: To what extent will information given by a company amounts to sufficient disclosure? To what extent will information disclosed enhance efficient management of a company? Are the existing disclosure mechanisms suitable or are there other institutional values to be taken into consideration in order to achieve a better result?

For the purpose of this article, companies with the standard and premium listing in the United Kingdom will be used as its focus.

This article is structured in five sections. The first is the introduction. The second section discusses the background of corporate governance which called for disclosure mechanisms. In this section, the essay examines the theoretical frameworks that support the development of corporate governance alongside its emergence, importance, aims and objectives.

The third section analyses some regulatory framework that mandates disclosures for listed companies and the different information required to be disclosed vis-à-vis the function of the executive directors of a company in preparing information to be disclosed, its board of directors duty

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in disclosing the information, the role of the different committees of a company in assuring itself of the integrity of the information disclosed alongside the function of the external auditors as it concerns financial disclosures made by a company.

The fourth section analyses the weaknesses of the existing disclosure mechanism. It goes further to recommend means to aid existing disclosure mechanism improve in accuracy and the reliability of corporate disclosures.

The last section concludes the article and makes necessary suggestions to existing disclosure mechanisms.

THEORETICAL BACKGROUND OF CORPORATE GOVERNANCE

The term corporate governance is a frequently used phrase in today's business world. It is a discipline which is evolving and is dynamic in nature even though its underpinning frameworks date back in time.¹ Presently, there is no generally accepted definition of corporate governance but for the purpose of this research, the term corporate governance is defined as "... the system by which companies are directed and controlled".² Hence, corporate governance can be said to be the method by which companies are governed, and the purpose for which they are governed.³ The main frameworks that give explanation and analyse corporate governance are the agency theory, transaction cost theory and stakeholder theory.⁴ Each of these frameworks despite their common attributes, views corporate governance from different perspectives using vocabularies arising out of their different disciplines.⁵ This article will now examine these theories for an in-depth understanding of the concept of corporate governance.

Agency Theory

The early advocates of this theory are Berle and Means, Jensen and Meckling and also Fama and Jensen.⁶ The theory is founded on the separation of ownership of a company and the control over the company's actions.⁷ Jensen and Meckling explained agency theory to involve one or more owners also known as shareholders (principals) contracting with one or more people as managers (Agents) to carry out some service in their company which includes decision making on their behalf.⁸ Under the best circumstances, the contract between the shareholders and the managers should cover the best interest of both parties and both parties are expected to keep their own part of the contract, however, this is impossible because the managers in managing the company on behalf of the shareholders make decisions which affect their personal welfare as well as the welfare of the shareholders.⁹ The ability to make unsupervised decisions may lead them to make decisions in their best interests as against the interests of the owners. This can be said to be the source of the conflict between shareholders and managers inherent in agency theory. For instance, a manager's interest in receiving benefits like holiday packages, use of company's car and living on the company's property or a rented property paid by the company by virtue of his position may be against shareholders interest of profit maximization.¹⁰ Furthermore, the level of effort managers put in running a company may be a source of conflict with shareholders. It is argued that the fact that managers are not the owners of the company may make them work lesser hours than if they would have done if they have any shares in the company.¹¹ Again, conflict may arise because of the time frame managers are willing to spend in a company. Shareholders generally are concerned with long and short term financial prospects which may not be in the interest of managers who are concerned with

¹ Christine A. Mallin, *Corporate Governance* (3rd edn, Oxford University Press 2010).

² Jill Solomon, *Corporate Governance and Accountability* (3rd edn, John Wiley & Sons Ltd 2010) 5.

³ Brian Coyle, *Corporate Governance* (study text, 5th edn, ICSA Information & Training Ltd 2007) 4.

⁴ Bob Tricker, *Corporate Governance Principles: Policies, and Practice* (Oxford University Press 2009).

⁵ Solomon (n 3) 8.

⁶ Mallin (n 2) 14 and *ibid* 9.

⁷ Coyle (n 4) 6.

⁸ Solomon (n 3) 9.

⁹ Coyle (n 4) 6.

¹⁰ *ibid*.

¹¹ *ibid*.

short term financial prospect alone. The reason may be that they are paid bonuses for short term performance or because they do not expect to be in the company for a long length of time.¹² These examples suggest that the manager's interests are selfish because they are not the owners of the company. This ownership structure however is peculiar to the United Kingdom and other countries with similar market systems.¹³

Having examined the conflicts that may arise from an agency relationship, the question therefore is, how can shareholders control the excesses of managers? There are various monitoring techniques in which the interest of the shareholders and company managers maybe aligned.¹⁴ It is posited by the expounders of the theory that one of the ways in curbing the self-serving nature of managers is by including incentives targets in their contract of employment.¹⁵ They argued that the desire to benefit from the incentives will prompt the managers to meeting the targets, thus act in the best interest of the shareholders.¹⁶ To this end, managers will inevitably perform the bidding of shareholders in order to meet these targets and this helps to minimise the conflict of interest in agency theory.

Another monitoring means suggest that board of directors of companies should be more effective in monitoring the decisions of managers.¹⁷ This is possible if the members of the board as individuals and collectively performs the monitoring role amongst their other roles in the company.

A crucial proposition also made is that where the managers are obliged by the virtue of their contract to disclose information in the way the company is run, same will control their opportunism nature.¹⁸ In today's business environment, companies, especially listed companies are required by law to disclose certain information to their shareholders. For example, annual report and account which discloses information on the company's financial performance and financial position.¹⁹ The reasoning here is that because managers are accountable to the shareholders for decisions made and actions taken, the shareholders will become aware of the happenings of the company through the information disclosed. So in the bid to be seen as trustworthy, managers are likely to act according to their contract of employment and the law thereby protecting the interests of the shareholders. It is noteworthy however that the preparation of the annual report and account as well as the work of audit has its cost.²⁰

The monitoring schemes used by the shareholders in order to make sure that managers do not abuse the powers delegated to them is known as agency costs.²¹ Agency costs are the expenses resulting from managers' abuse of their delegated duties, as well as the expenses in monitoring and disciplining the actions of managers.²²

For the above reasons, agency theory provides an understanding of how corporate entities are regulated. It focuses on the incentive schemes and governance mechanisms that protect the interests of the shareholders despite conflicts which arise out of the relationship with managers of their company. Thus the next subsection analyses transaction cost theory.

Transaction Cost Theory

The expounders of the theory view companies not just as economic entities but as an organisation with different people with different aims and intentions.²³ The theory is concerned with the governance of contractual relationship in a way that leads to lowered costs of the operations of

¹² *ibid* 7.

¹³ Solomon (n 3) 10.

¹⁴ *ibid*.

¹⁵ *ibid*.

¹⁶ Kathleen A Eisenhardt, 'Agency Theory: An Assessment and Review' (1989) 14 *Academy of Management* 57, 62.

¹⁷ Coyle (n 4) 7.

¹⁸ Eisenhardt (n 16) 60.

¹⁹ Coyle (n 4) 7.

²⁰ *ibid*.

²¹ Mallin (n 2) 15.

²² *ibid*.

²³ Solomon (n 3) 13.

the company.²⁴ This costs results from the set up of a company, the costs for running the company as well as other costs that arise from a shift in initial agreements.²⁵ The theory is related with the argument of Coase²⁶ and Williamson, who built his theory on the work of Coase.²⁷ They argue that in a competitive environment, the operations of the company can either be carried out in-house or through market transactions.²⁸ For example, a company in need of a warehouse can either spend money maintaining its goods at a rented warehouse or build a warehouse within its business premises and not pay costs at all for the use of its warehouse. What then determines when a company carries on operations in-house or through market transactions? It is argued that the company's decision on which means to carry out operations should depend on which is cheaper.²⁹ However, it is pertinent to note that should the company decide to carry on business operations in-house, it will need an organisational structure and a hierarchy of authority with senior management at the top.³⁰ Having an organisational structure is in accordance with the provisions of transaction cost theory which provides that the organisational structure of the company and its relationship with shareholders as well as the managers depend on the amount of transaction performed in-house.³¹ The act of carrying on business operations in house is referred to as vertical integration.³² Williamson posits that performing operations in-house economises production costs, transaction costs as well as removes the risks and uncertainties about prices and quality of products and services as well as the risk of dealing with suppliers to an extent. The elimination for the risks of dealing with higher prices of goods, quality of products and untrustworthy suppliers saves the company's resources and reduces its business risk. For example, a company that owns its warehouse removes the risk of prices with other warehouse owners and this is advantageous to the company.

Despite the advantages of carrying on business operations in-house, transaction costs theory recognises the proclivity of two examples of human nature which affects business operations transacted in-house.³³ These are:

- Bounded Rationality: It has been defined as behaviour that was intentionally rational but limited within understanding.³⁴ An example will be where managers of a company make decisions in good faith but still accrue more costs on the company than they should because of their limits in understanding a particular business venture or their inability to anticipate actions of competitors or where the managers take a risk that backfires on them.
- Opportunism: This is defined as a "self interest seeking with guile".³⁵ An example will be where managers manage the company for their selfish interest or where they act in good faith, still have to deal with 3rd parties who are opportunistic in nature. The former example is the reason why shareholders have to control their agents be it through the use of contracts. This is a similarity of transaction cost theory with agency theory while the latter is one of the reasons for vertical integration.

Although agency theory and transaction cost theory view corporate governance from different perspectives, they both agree on the need for shareholders to control managers.

²⁴ Rahul Kochhar, 'Explaining Firm Capital Structure: The Role of Agency Theory vs. Transaction Cost Economics' (1996) 17 Strategic Management Journal 713, 715.

²⁵ *ibid.*

²⁶ Tricker (n 5) 223.

²⁷ *ibid.*

²⁸ Coyle (n 4) 8.

²⁹ *ibid.*

³⁰ *ibid.*

³¹ *ibid.*

³² Oliver E Williamson, 'Transaction Cost Economics: The Governance of Contractual Relations' (1979) 22 Journal of Law and Economics 233, 234.

³³ Michael J. Leiblein and Douglas J. Miller, 'An Empirical Examination of Transaction- and Firm-Level Influences on the Vertical Boundaries of the Firm' (2003) 24 John Wiley & Son 839, 841.

³⁴ Solomon (n 3) 14.

³⁵ *ibid.*

Stakeholder Theory

The call for this type of management started in the 1970s.³⁶ Unlike agency and transaction cost theories, stakeholder theory does not only describe current circumstances or predict relationships, it recommends a balance of responsibility, accountability, structures, attitudes and practices in a company.³⁷ Freeman, one of its early contributors proposed that for a company to be stakeholder conscious, it has to incorporate corporate accountability of the company managers to a broad range of stakeholders.³⁸ The basis for this is because the company enters into a wide range of legal relationship with other persons or groups besides their legal relationship with their shareholders, thus under the duty to protect such relationship.³⁹ The supporters of this theory further argue that the shareholders interests are met only when the company takes into account the interests of other stakeholders.⁴⁰ Who then are these other stakeholder's in a company and how are they identified? Stakeholders have been identified to be individuals or groups with justifiable interest in the way a company is managed and they are identified by their interest in the company and not whether the company have the same functional interest in them.⁴¹ Following from this, the stakeholders of a company have been identified to include its employees, suppliers, customers, lending institutions, the community in which they operates, the government and the general public.⁴²

Stakeholder theory calls on managers to not only consider the interest of their shareholders who too are stakeholders in the company being owners but to consider the interest of other persons or groups who the company also have relationships with as they also have their interest in the company which its managers should attempt to meet. This article aligns with the stakeholder theory for its attempt to protect every party with an interest in the company unlike the other theories discussed.

Having discussed the underlying frameworks that underpin the advancement of corporate governance, this article will now examine the importance of corporate governance, its aims and objectives with the role of disclosure to foster good corporate governance.

As written in the introduction section of this research, the recent growth of corporate governance can be attributed to the recent financial crisis, corporate scandals, failed companies and other negative occurrence in the business world. One of the many corporate scandals worth mentioning to augment the importance of corporate governance is the collapse of Enron, a leading energy trading company in the United States of America. In 15 years of its incorporation, Enron grew so large that it became the 7th largest company with over 20,000 staff in over 40 countries, including the United Kingdom⁴³ where it was the first company to begin construction of a power plant at the deregulation of the United Kingdom's energy sector.⁴⁴ It had series of award for its continuous achievements until the late 1990s when its signs of distress began to show until the company finally filed for bankruptcy.⁴⁵ Examples of the woes of Enron include when it wrote off \$537 Million to resolve a contract dispute over North Sea Gas in 1997 and when in 2001, Dynegy, a competitor with which Enron was working at merging with, pulled out of the merger when Enron's accounting scam began to appear. At this time also, the company credit rating by Moody's credit rating agency fell to barely above that of junk bonds.⁴⁶ On the 2nd of December 2001, the company filed for Chapter 11

³⁶ Solomon (n 4) 14.

³⁷ Thomas Donaldson and Lee Presto, 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications' (1995) 20 Academy of Management Review 65, 66 and 67.

³⁸ Solomon (n 3) 14.

³⁹ *ibid* 15.

⁴⁰ *ibid* 6.

⁴¹ Donaldson and Presto (n 38) 67.

⁴² Coyle (n 3) 8.

⁴³ BBC News, 'Enron Scandal at-a-glance' (*Business*, 22 August 2002) <<http://news.bbc.co.uk/1/hi/business/1780075.stm>> accessed 3 March 2013.

⁴⁴ BBC News, 'Rise and Fall of an Energy Giant' (*Business*, 28 November 2001) <<http://news.bbc.co.uk/1/hi/business/1681758.stm>> accessed 3 March 2013.

⁴⁵ *ibid*.

⁴⁶ Solomon (n 3) 30 and 31.

bankruptcy. This sort of bankruptcy allows a company to reorganise while being protected from creditors.⁴⁷

Enron's scandal amongst others showed the world the effects poor corporate governance may have on a company. The scandals in Enron which eventually led to it filing for bankruptcy were a wakeup call for the need and importance for good corporate governance for a company to succeed. The importance of corporate governance cannot be overemphasized. The following are some aims, objectives and important characteristics of corporate governance:⁴⁸

- i. Corporate governance encourages transparency and accountability in the way a company is run.
- ii. Corporate governance tries to ascertain that adequate system of control is in place to safeguard company's assets.
- iii. Corporate governance tries to guarantee that the company is run in the best interest of the shareholders and other stakeholders as introduced in the theoretical framework.
- iv. Corporate governance tries to stop an individual or a group of individuals controlling the company.
- v. Corporate governance is concerned with the type of relationship that exists between the company's managers, board of directors, shareholders and other stakeholders. It aims at balancing the demands and needs of these individual groups.

In the next section, the article considers the Rule which mandates the disclosure of certain information in a company. It also considers another Rule and Code which provides for disclosure as well but gives room for the company to explain noncompliance of any of its provisions. It considers the different information mandated to be disclosed and information not mandated to be disclosed, yet disclosed by companies to foster investor's confidence. The article considers these vis-à-vis the functions of the executive directors of a company in preparing the information to be disclosed, the role of its board of directors in disclosing the information, the role of the different committees of a company in assuring itself of the integrity of the information disclosed alongside the functions of the external auditors.

DISCLOSURE AND CORPORATE GOVERNANCE

Disclosure relates to the different information produced by companies, such as its annual report, which contains the director's report which must include amongst others a business review, the profit and loss account, balance sheet, cash flow statement and other required items.⁴⁹ The company's financial reports and its disclosure are the main ways management communicates with its shareholders, investors and potential investors.⁵⁰ At present, some companies, in addition to producing mandatory reports, report also on items which relates and affect their type of business to proof their worth to investors and potential investors, such information is called voluntary disclosure as they go beyond the mandated minimum.⁵¹ Examples are presentations at Annual General Meetings (AGM), press releases and management forecasts. The question this type of disclosure raises on the other hand is the quality and truthfulness of same as the information is not mandatory neither is it audited. Be that as it may, the act is encouraged as it improves transparency which is one of the objectives of corporate governance, fosters confidence of the investors on their investee companies and reduces information asymmetry.

For companies listed on the London Stock Exchange, The Financial Services Authority Disclosure Transparency Rules set out certain mandatory disclosures on them as a means to achieving good corporate governance⁵² while its Listing Rules and the UK Corporate Governance

⁴⁷ *ibid* 28.

⁴⁸ Mallin (n 2) 8.

⁴⁹ Solomon (n 3) 152.

⁵⁰ Paul M. Healy and Krishna G. Palepu, 'Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature' (2001) 31 *Journal of Accounting and Economics* 405, 406.

⁵¹ *ibid*.

⁵² Financial Reporting Council, *The UK Corporate Governance Code 2010*, Sch B 28.

Code gives room for a comply or explain disclosure regime.⁵³ It is important to state that the UK Corporate Governance Code is a codification of different corporate governance codes. Besides providing for a comply or explain requirement, it mandates companies to disclose specified information so as to comply with certain provisions of the FSA Disclosure and Transparency Rules.⁵⁴ The sections of the Listing Rules and that of The UK Corporate Governance Code used in this research apply to companies with Premium listing only on the London Stock Exchange. The provisions of the Disclosure and Transparency Rules are set out below:

Sub-chapter 7.1 of the Disclosure and Transparency Rules deals with the audit committee of listed companies or bodies in the company with similar functions of the audit committee while DTR 7.1.1 R to 7.1.3 R sets out requisites of the composition and functions of the committee or its similar body.⁵⁵ The disclosures required of this subchapter are in DTR 7.1.5 R to DTR 7.1.7 G:⁵⁶ They state:

- DTR 7.1.5 R: That listed companies must make a statement to the public disclosing which body performs the functions of the audit committee and how the body is composed.
- DTR 7.1.6 G: This provides that the statement to be made according to the provisions of DTR 7.1.5 R can be added in the corporate governance statement as directed in DTR 7.2.
- DTR 7.1.7 G provides that the observance of relevant provisions of the UK Corporate Governance Code (set out hereafter) will be compliance with DTR 7.1.1 R to 7.1.5 R.

Subchapter 7.2 provides that the corporate governance statements to be produced must either be contained in the director's report or in a separate report disclosed at the same time with the annual report or disclosed on the company's website. Where disclosure is made on the company's website, there must be a cross-reference in the director's report.⁵⁷

DTR 7.2.2 R specifies that the corporate governance statements must include a reference to the corporate governance code which regulates the company (In the United Kingdom, the corporate governance code is, The UK Corporate Governance Code which regulates companies with a premium listing)⁵⁸.

- DTR 7.2.3 R further to the directive of DTR 7.2.2 R provides that where the company is not in compliance with the provisions of the Code, the company must state the provisions of the code it departed from and explain its reasons for doing so.⁵⁹
- DTR 7.2.4 G provides that compliance with Listing Rules 9.8.6 R (6) will satisfy the provisions of the Disclosure and Transparency Rules. (The provisions of the Listing Rules will be set out hereafter).⁶⁰

The mandatory disclosure as given by the Disclosure and Transparency Rules directs listed companies to provide the following in their corporate governance statement:

- DTR 7.2.5 R: This provides that the corporate governance statement must include a description of the main qualities of the internal control and risk management systems of the company taking into account the financial reporting process. DTR 7.2.10 R provides for group companies. It directs the holding company to produce a group director's report which must state a description of the main qualities of the group's internal control and risk management systems of the company taking into account the process for preparing consolidated accounts.⁶¹
- DTR 7.2.6 R: This provides that the corporate governance statement must include information stated in paragraph 13 subparagraph (2)(c), (d), (f), (h) and (i) of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations

⁵³ *ibid.*

⁵⁴ *ibid.*

⁵⁵ *ibid.*

⁵⁶ *ibid* 29.

⁵⁷ *ibid.*

⁵⁸ *ibid.*

⁵⁹ *ibid.*

⁶⁰ *ibid.*

⁶¹ *ibid* 30.

2008 if the company is obliged to comply with the requirements of that paragraph.⁶² The mentioned Paragraph in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 concerns the directors' report of a company where the company's securities carrying voting rights, traded on a regulated market as at the end of that year.⁶³ The specific provisions required by the Disclosure and Transparency Rules in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 in paragraph 13 are:

- 13. (2) The directors' report in reference to the end of that year, must include comprehensive information, on the listed items below:
 - (c) where an individual has a significant direct or indirect holding of securities in the company, the details below should be known to the company:
 - (i) the identity of the person,
 - (ii) the size of the security holding, and
 - (iii) the nature of the security holding;
 - (d) where the individuals securities holding carry special rights with regard to control of the company:
 - (i) the identity of such individuals, and
 - (ii) the nature of the special rights;
 - (f) the directors' report should include any restrictions on the company's voting rights, especially:
 - (i) restrictions on voting rights of holders of a given percentage or number of votes,
 - (ii) the time limit for exercising voting rights, and
 - (iii) procedure where an individual other than the holder of the securities with the company's co-operation have financial rights;
 - (h) any conditions that the company has pertaining to:
 - (i) appointment and replacement of directors, or
 - (ii) amendment of the company's articles of association;
 - (i) the powers of the company's directors, including any authority in relation to issuing or buying back by the company of its securities;

This article will now consider the last two provisions of the DTR as it relates to mandatory disclosure by companies. DTR 7.2.7 R directs that a company's corporate governance statement must give account of its composition and operations of administrative, management and supervisory bodies and their committees.⁶⁴ DTR 7.2.8 G states that compliance with the significant provisions of the UK Corporate Governance Code will satisfy the requirement of DTR 7.2.7 R.⁶⁵

This article will now consider the requirements of the Listing Rules. It is pertinent to state that one of the conditions of admitting companies' shares on the stock market in the United Kingdom is the companies' undertaking to make frequent and periodic disclosures on the companies' financial and non financial affairs in compliance with the Listing Rules.⁶⁶ This disclosure does not end here, listed companies are still subject to the Listing Rules continuous disclosure requirements.⁶⁷ Where the company does not comply with the provisions of the Listing Rules, the company is to explain in its annual report the reasons for its noncompliance.⁶⁸

⁶² *ibid.*

⁶³ The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, sch 7(13).

⁶⁴ Financial Reporting Council (n 53) 30.

⁶⁵ *ibid.*

⁶⁶ Len Sealy and Sarah Worthington, *Cases and Materials in Company Law* (8th edn, Oxford University Press 2008).

⁶⁷ *ibid.*

⁶⁸ Stephen Mayson, Derek French and Christopher Ryan, *Company Law* (26th edn, Oxford University Press 2009).

Listing Rules 9.8.6 R apply to companies incorporated in the United Kingdom while 9.8.7 R apply to overseas incorporated companies.⁶⁹ The Rules provides that the annual report and accounts of a listed company must consist of the following information:⁷⁰

- a statement of how the listed company has complied with the main principles in the UK Corporate Governance Code in a manner that would enable shareholders understand the company's compliance.
- a statement to also include:
 - if the company complied throughout the accounting period with the relevant provisions in the UK Corporate Governance Code; or
 - where the company does not comply with all the relevant provisions in the UK Corporate Governance Code throughout the accounting period, it should set out:
 - (i) the provisions not complied with;
 - (ii) where noncompliance is with provisions that require a continuing nature, the period within which the company did not comply with parts or all of those provisions; and
 - (iii) the company's explanation for noncompliance.

This article will now analyze the provisions of the UK Corporate Governance Code. Further to the Listing Rules comply or explain obligations on disclosure. The Code requires for specific disclosure which must be provided in order for listed companies to comply with the Listing Rules.⁷¹ It provides for the following items in a listed company's annual report:⁷²

- a statement on how the board of directors of the company operates. The statement should include the types of decisions reserved for the board and types of decisions which are delegated to the company's management (A.1.1);
- the name of the listed company chairman and where there is a deputy, the name of the deputy chairman as well as the names of the chief executive, the senior independent director and the chairmen and members of the board committees (A.1.2);
- the number of times the board meets, the number of times the board committees meet and the individual attendance by directors (A.1.2);
- if the chief executive officer is appointed as chairman of the company, the company should state its reasons for doing so. This disclosure needs to be in the company's annual report after the appointment (A.3.1);
- the names of the non-executive directors whom the board verifies as independent, with the board's rationale where necessary (B.1.1);
- a separate section in the annual report should explain the role of the nomination committee and the procedure the committee used in board appointments. Where the committee did not use external search consultancy nor open advertisement in the appointment of the chairman or a non executive, an explanation should be given. (B.2.4);
- any substantial changes to the commitments of the chairman during the year (B.3.1);
- a statement on the procedure the board used in carrying out performance evaluation on itself, its committees and directors (B.6.1);
- directors explanation on their responsibility to prepare the accounts and a statement by the auditors on their reporting responsibilities (C.1.1);
- a description by the directors on the company's business model and the strategy in place aimed at achieving the company's objectives (C.1.2);
- a statement and evidence where necessary to show that the business is a going concern (C.1.3);

⁶⁹ Financial Reporting Council (n 53) 30.

⁷⁰ *ibid.*

⁷¹ *ibid* 31.

⁷² *ibid.*

- a report by the board with information that it has conducted a review on the effectiveness of the company's risk management and internal control systems (C.2.1);
- a separate section which explains the role of the audit committee in discharging its responsibilities (C.3.3);
- if the company has no internal audit function, an explanation for its nonexistence should be given (C.3.5);
- the audit committee is make a statement explaining its recommendation on the appointment, reappointment or removal of an external auditor in the event that its recommendation is not approved by the board. The statement should also explains the board's refusal (C.3.6);
- an explanation of the policy to protect the external auditor's objectivity and independence where the auditor provides non-audit services (C.3.7);
- an explanation of the function of the remuneration committee as directed by the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008. Also, an explanation on whether or not a an executive director who takes up the position of a non-executive director in another company, retains such earnings and what the remuneration is (D.1.2);
- the measures by the board to ensure that its members especially the non-executive directors are aware of the opinions of their major shareholders about the company (E.1.2).

In addition to the above disclosure, the board should also make available the following information which may be placed on the company's website.⁷³

- the job description, its explanation of the role and the authority delegated to the nomination, remuneration and audit committees of the company (B.2.1, C.3.3 and D.2.1);
- the basis of appointment of non-executive directors (B.3.2);
- if the performance evaluation of the board is carried out by an external facilitator, a statement should be made if the facilitator has any other relationship with the company (B.6.2); also
- if the company uses remuneration consultants in setting the remuneration of its directors, a statement should be made if the remuneration consultants have any other relationship with the company (D.2.1).

Also, where a resolution to elect or re-elect directors has been made, the board of directors of the company are expected to disclose to the shareholders in papers accompanying the resolution the following information.⁷⁴ This information is to enable the shareholders make an informed decision:

- adequate biological details of the directors up for election or re-election (B.7.1);
- reasons why an individual should be elected to a non-execution function (B.7.2);
- where a non-executive director has been re-elected, the chairman is to confirm to the shareholders that after a performance evaluation of the non-executive director, the non-executive continues to be effective and committed to the job function (B.7.2).

Again, where the board recommends an appointment or reappointment of an external auditor to the shareholders, the board should disclose in the papers following the recommendation whether or not it accepted the recommendation of its audit committee.⁷⁵ In the event that the board does not accept its audit committee recommendation, the audit committee should in a statement explain its recommendation. The board is also required to state its reasons in a statement for taking a different position (C.3.6).

Having examined the different information especially information relating to financial accounting required of a listed company to be disclosed, the advantages of disclosure mechanisms can therefore be seen to include amongst several reasons first to encourage directors to act more

⁷³ *ibid* 32.

⁷⁴ *ibid* 33.

⁷⁵ *ibid*.

meticulously and honestly in their duties because they know their actions will be regularly exposed.⁷⁶ This imminent threat of public exposure can prevent corporate and fraudulent behaviour in the directors from occurring in the first place. Hence, a reduction in agency costs as there is no need for shareholders to incur expenses monitoring the directors to ensure they perform their duties properly.⁷⁷

Secondly, information disclosure helps investors to make fully informed investment decisions whether or not to invest in a company.⁷⁸ Hence when disclosure is made, it levels the playing field so that all market participants have equal access to information about a company. Investors can then on the basis of information disclosed make informed decision whether or not investing in a company's securities is worthless.⁷⁹ This is based on the argument that without disclosure, investors would have inadequate information with regards the risks related with any particular company. Hence, disclosure promotes fairness and enables the investors with information to make wise business choices.⁸⁰

Thirdly, besides from investors using disclosed information to make wise investment decisions, disclosed information also fosters investors confidence in securities market. Again, this is achieved with the backing of disclosure rules and codes that deter fraudulent corporate conduct and equalize access to information which boosts investor trust and confidence.⁸¹ The company in turn gains capital from the capitals investor brings to the market. The capital company would have sought for from other sources is now made available to it at lower prices.⁸²

In addition to this, disclosure decreases investors risks and protects the public interest.⁸³ Disclosure rules and codes ascertains this by directing companies to disclose certain information about the conduct of its directors in managing it but the rules and codes preserves the autonomy of investors to decide for themselves whether the conduct of the company's managers is sufficient to encourage or discourage the purchase of company's securities rather than the rules and codes prohibiting certain forms of conduct.⁸⁴ Hence the advantage of disclosure mechanism is that it promotes the protection of investors and the public interest without interfering with the company's operation. This article will now discuss the weaknesses of existing disclosure mechanism and recommended solutions to the challenges of existing disclosure mechanism.

WEAKNESSES IN EXISTING DISCLOSURE MECHANISM

The recent global financial crisis and its negative effect to the business world occurred despite the awareness of corporate governance and disclosure standards with the function of executive directors and other checks on the executive directors and information they disclosed in corporate governance in place. This raise questions as to how and why the crisis occurred with the mechanisms in place to protect against such failures in the business world.

One of the fundamental weaknesses in disclosing information is the difficulty in presenting information that is simple to read and help understand the operations and structures of companies.⁸⁵ This can be attributed to the formalized language written by company's lawyers to protect the company's liability rather than provide investors with meaningful information.⁸⁶ Thus, investors often lack the ability when faced with disclosure in a formalized language to comprehend same, talk more of using the disclosed information effectively. As a result of this situation, disclosure

⁷⁶ Ripken, Susanna Kim, 'The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation' (2006) 58 Baylor Law Review 139, 151.

⁷⁷ *ibid* 152.

⁷⁸ *ibid*.

⁷⁹ *ibid* 153.

⁸⁰ *ibid* 154.

⁸¹ *ibid*.

⁸² *ibid*.

⁸³ *ibid* 155.

⁸⁴ *ibid*.

⁸⁵ *ibid* 148.

⁸⁶ *ibid*.

does not achieve its aim in communicating to investors so as to enable them reach informed decision.

Another limitation to disclosure can be seen where even though relevant information is made public, disclosure still results in confusion and poorer decision making by investors.⁸⁷ This occurs when the investor simply cannot decipher the information before him so as to make reasoned decision in his favour. Where this is the case, the purpose of disclosure mechanism is defeated especially where investors who took cognizance of the information disclosed made losses over other investors that disregarded the information disclosed.⁸⁸ Hence, disclosure may not be a suitable mechanism for regulating corporate governance.

Another weakness in disclosing information which is evident from the psychological literature point of view is that as a general rule, people tend to think that they are better at achieving targets than others.⁸⁹ Applying this line of reasoning to companies, executive directors tend to think that their company is better than their competitors, thus perform better in business.⁹⁰ They develop an exaggerated sense on the value of the type of business the company does and the quality of the services or products the company supplies.⁹¹ This illusion drives them to think that positive results in the company were by their efforts and bad results were caused by external constraint beyond their control. This attitude is seen in the annual report and accounts of their company where favourable outcomes are presented to be as a result of company strategy and managerial efforts while unfavourable outcomes are blamed on external circumstances such as a new government policy.⁹² Even in presenting forecasts about the company, this attitude can bring about the executives overestimating their ability to predict the future accurately. This over-confidence attitude in the executives may lead to presenting rather distorted information to shareholders and the public.⁹³ Executive directors are not the only ones with unwarranted confidence, investors too may also be over confident in their ability to make wise investment decisions. This is evident where they think that positive investment outcomes are due to their skills and strategies to read between the lines of corporate disclosures to ascertain which company's disclosure is truthful and can be trusted.⁹⁴

A crucial weakness in disclosure worth discussing is the cost of same because a company incurs a lot of costs gathering, analyzing, drafting and editing all the information needed to generate the required disclosure which involves extensive time and efforts from the executive directors, members of staff, lawyers and accountant. Arguably, the cost implication may be beyond the capability of a company.⁹⁵

There is uncertainty in disclosure being a suitable mechanism for regulating corporate governance as it fails to serve its purpose of effective means of communicating to investors and potential investors. This calls for the need of alternative means to protect investors and the next section of the research recommends other institutional mechanisms to support disclosure mechanisms in protecting investors. The following are its recommendations:

The Role of the Board of Directors:

Company as a juristic entity can only function through the functioning of its human representatives. Hence, the board of directors is charged with the responsibilities of running the company.⁹⁶ In order to achieve an effective board, this research supports the recommendation of the UK Corporate Governance Code where it states that the spirit and letter of the code should be

⁸⁷ *ibid* 160.

⁸⁸ *ibid* 162.

⁸⁹ *ibid* 163.

⁹⁰ *Ibid* 164.

⁹¹ *ibid*.

⁹² *ibid* 165.

⁹³ *ibid*.

⁹⁴ *ibid* 166.

⁹⁵ *ibid* 188.

⁹⁶ Solomon (n 3) 78.

embraced.⁹⁷ It further recommends every company to have a board that acts collectively for the success of the company.⁹⁸ To ascertain the effectiveness on the board, there should be a clear cut division on the roles of the personnel heading the board between the roles of the individual responsible for running the company business.⁹⁹ This creates a platform for the individuals to act as checks and balances on themselves to avoid a person to dominate the company. In the event however that the board decides that its chief executive officer occupy the position of its company chairman, the company's major shareholders should be consulted with the board's reasons prior to its decision.¹⁰⁰ Following from this, the appointment of board members should go through a formal, rigorous and transparent manner so as to appoint only qualified personnel who will serve on the board and on its committees.¹⁰¹ Also, directors on appointment whether executive or non-executive, directors should receive induction to enable them know the company so as to perform their responsibilities effectively. They should also undergo training from time to time to refresh their skills and knowledge.¹⁰² To properly function, the board should be given information in a timely manner.¹⁰³ To further determine that board members do not lose sight of their responsibilities, the board with the chairman taking the lead should perform an evaluation on itself individually and collectively and they should be submitted at uniform intervals for re-election subject to their performance.¹⁰⁴

Credit Rating Agencies:

The role played by Credit Rating Agencies cannot be over emphasised. They have in the past given good ratings to companies that did not deserve same even when they were presented with inadequate historical data and in some instances flawed models.¹⁰⁵ They have also rated companies in which they had helped structure their instrument.¹⁰⁶ This act is wrong as they like auditors should not be seen to be rating instruments they have advised on. All these practices by rating agencies have contributed to the recent financial crises and have made investors lose value of the quality of the rating given by credit rating agencies.¹⁰⁷ This certainly calls for improvement in the how ratings are made, and more importantly, how they are used¹⁰⁸.

Accounting Standards:

It was observed in the recent financial crisis that companies employed the use of off-balance sheet wrongly even after the United States of America (USA) tightened the use of such in the wake of Enron's scandal. The use of off-balance sheet allowed companies to present their companies favourably to shareholders by taking off some transactions of the company balance sheet.¹⁰⁹ This article suggests that stricter accounting standards be implemented and recommends that off balance sheet transactions should be included in the balance sheet of financial institutions so that their true state of accounts will be known to investors and the wider state.

Regulatory Framework:

For corporate governance to be seen as thriving there is the need to have an effective, well resourced supervisory regulatory and enforcement authority of corporations law with clear cut responsibilities which will be managed in a transparent manner.¹¹⁰ This will go a long way to protect

⁹⁷ Financial Reporting Council (n 53) 2.

⁹⁸ *ibid* 6.

⁹⁹ *ibid* 10.

¹⁰⁰ *ibid*.

¹⁰¹ *ibid*.

¹⁰² *ibid*.

¹⁰³ *ibid*.

¹⁰⁴ *ibid* 16 and 17.

¹⁰⁵ Grant Kirkpatrick, 'The Corporate Governance Lessons from the Financial Crisis' [2009] Financial Market Trends © OECD 1, 25 and John Lessing, 'The Checks and Balances of Good Corporate Governance' (2009) Corporate Governance eJournal 2, 5.

¹⁰⁶ Kirkpatrick (n 106) 25.

¹⁰⁷ *ibid*.

¹⁰⁸ *ibid*.

¹⁰⁹ *ibid* 26.

¹¹⁰ *ibid* 27.

investors, restore their confidence in the capital markets as well as act as checks to companies. The next chapter will conclude this article.

CONCLUSION

This article examined disclosure as a suitable mechanism to regulate corporate governance and considered if the existing disclosure mechanisms are sufficient. The goal of the article was to emphasize the role of disclosure in order to achieve good corporate governance as a means of resolving the conflict of interests between managers, shareholders and stakeholders. This article found that disclosure has its weaknesses thus made recommendations to improve the disclosure of information on corporate activities to investors so that they can make informed investment decisions. With full disclosure, the price of security can be expected to shift less drastically because there is more accurate public information. This article started out by looking at some of the frameworks from which the need of corporate governance emerged, namely agency theory, transaction cost theory and stakeholder theory. Even though this article is not aimed at these frameworks, it stated its support for the stakeholder theory because of its attempt to put into consideration the interest of every party with a stake in the company when making decisions on behalf of the company. The article further examined the importance, aims and objectives of corporate governance which amongst other characteristics is to foster transparency and accountability in the way a company is run. To achieve this, disclosure has a major role to play. The article used the company Enron as its case study to buttress the importance of disclosure in corporate governance.

The third section of the article examined certain mandatory disclosure provisions of the FSA Disclosure Transparency Rules which companies listed on the London stock exchange have to comply with. It also looked at disclosure provisions of the FSA Listing Rules and the UK Corporate Governance code which applies to companies with premium listing only on the London Stock Exchange even though the Listing Rules and Code make room for a comply or explain requirement. The provisions of the Rules and Code provide a platform from which corporations can build on in disclosing information which protects the interests of shareholders and the wider public. The article also mentioned the new practice in companies to disclose information not mandated to be disclosed. This also goes a long way to foster investors confidence in a company. The article further discussed the advantages of disclosure as seen from these provisions. All these disclosure provisions go a long way to resolving the conflicts in interest of all stakeholders in a company hence ultimately protecting shareholders and boosting their confidence in invested companies.

Despite the advantages of disclosure, same is not without its weaknesses, accordingly the forth section of the article analyzed the weaknesses in disclosing information and named the difficulty in presenting information as one of the fundamental weaknesses of disclosure, reason being that the language used in disclosing information about a company are full of legal jargons which then makes understanding difficult which then lead to information asymmetry. As a consequence of the weaknesses in disclosure and the quality of negative effect it could have on investors in a company, this article recommended the use other institutional mechanisms to aid disclosure mechanisms so as to ensure its effectiveness in disclosure for good disclosure in reality produce accurate information. The research employed a company's board of directors and auditors to be efficient its monitoring and other roles. It also called for improvement in the role of credit rating agencies and accounting standards so as to uncover companies misconduct. The article further recommended for well resourced supervisory regulatory and enforcement authority which will in addition to other checks still check the acts of companies to ensure that they are run in a transparent manner. This article believes that financial and non financial reporting with disclosure produces price stability and diminishes market volatility. As can be seen throughout this article, the article supports the credibility of disclosure only if the information is true as it enables investors react appropriately.