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The Quality of Explanations for Deviation from Principles of Corporate Governance. An Introduction

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Abstract

Purpose: The purpose of this paper is to summarize studies aiming to define matters related to the quality of explanations found in corporate governance statements published by listed companies. Another important aspect of the conducted analysis is the identification of various dimensions of explanation quality.

Methodology: The character of the conducted research is that of an overview of literature devoted to the subject. Apart from scientific articles, it covers European Union regulations, regulations characteristic of countries selected for the analysis (member states of the European Union), and applied solutions aimed at guaranteeing the desired quality of explanations for deviation included in corporate governance statements that are in the centre of attention.

Findings: The conducted analysis organizes the current knowledge concerning actions aimed at improving the quality of explanations for deviation from principles of corporate governance. Without a doubt, the primary pillar consists of the level of information and its quality, as found in explanations for shareholders. It is this quality that determines if the shareholder understands the processes occurring in the realm of corporate governance in the company.

Research limitations: The conducted analysis should be treated as an introduction to related research issues. It should be stressed that research into explanations provided by companies is still in the process of development, and the number of publications devoted to this topic is still modest.

Practical implications: The study fits in the research into the phenomena of the "comply or explain" mechanism as applied in practice, which according of many researchers, continues to be poorly investigated. In terms of the directions for further research, there are promising topics including e.g. identification of factors that may translate into the quality of such statements (e.g. ownership structure, identity of shareholders), the role that should be played by institutions involved in developing CG codes (i.e. their successive versions), and the involvement of the board of directors/supervisory board in the evaluation process.

Originality: The present paper identifies the key factors perceived as determining the quality of corporate governance statements. In addition to that, it outlines new avenues for further investigation.

Keywords: principles of corporate governance, code of corporate governance, corporate governance statements, explanation for deviation

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Introduction

The quality of the explanation for deviation from principles of corporate governance[2], which is a part of a corporate governance statement, is the main topic of interest in this paper. A result of implementation of the "comply or explain" principle, explanation is an important aspect of the process of building corporate transparency. The "comply or explain" principle, in turn, regulates the application of corporate governance best practices. The character of such practices is an instance of company self-regulation (soft law). Among other objectives of such self-regulations, best practices provide rules for the operation of the top management, boards of directors/supervisory boards, and the shareholders themselves with respect to communication and information policy, execution of supervisory functions, and formation of systems of internal control and motivational mechanisms for top management (Aguilera and Cuervo-Cazurra, 2004).

The "comply or explain" principle guarantees company flexibility in the area of corporate governance[3], where the company can select the most suitable solution. This flexibility is in line with the diversity among companies, so that the solutions companies apply in the sphere of corporate governance are determined by their needs in the area in question. However, it should be remembered that the options selected for company operations should also be aimed at satisfying the needs of company shareholders as well as any other stakeholders.

It should be also stressed that absence of the application of principles as found in best practice codes is not bad practice (Hooghiemstra and van Ees, 2011). Bad practice is any failure to provide information that such principles are not applied – together with explanations as to why they are actually refrained from. Such actions may also suggest that the top management is trying to gain an advantage over shareholders, which comes from an asymmetry of information, which decreases the level of monitoring of management's actions by shareholders (Luo and Salterio, 2014; Fama and Jensen, 1983).

Solutions found in explanations of the departure from corporate governance best practices, being different from those proposed by corporate governance codes, may become a starting point for the creation of new best practices. Thus, such explanations

2 Principles of Corporate Governance are also referred to as the Corporate Governance Code of Corporate Best Practices, Corporate Governance Code. These terms will be used interchangeably in the paper.

3 According to the G20/OECD definition, "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders" (OECD 2015, p. 9).

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take on a special significance (e.g. Hooghiemstra and van Ees, 2011; Shrives and Brennan,2015). As indicated above, the basic source of explanations is a given company's declaration regarding corporate governance best practices (corporate governance statement). The quality of these explanations, understood on a multidimensional level, is at the heart of this paper. An overview of the literature devoted to the subject serves as an introduction to questions of the quality of explanations incorporated into corporate governance statements. Its primary objective is to summarize studies making efforts to define the matters of quality of explanations found in corporate governance statements published by listed companies. An important aspect of the conducted analysis involves also identification of various dimensions of explanation quality.

At this point it is worth adding that according to Shrives and Brennan, research into explanations provided by companies is still in a developmental phase (Shrives and Brennan, 2015). The basis behind such an opinion is the still limited set of available publications devoted to the topic (e.g. MacNeil and Li, 2006; Pass, 2006; Andres and Theissen, 2008; Arcot, Bruno, and Faure-Grimaud, 2010; Hooghiemstra, 2012; Seidl et al., 2013). However, we have seen a gradual growth in the number of works covering the subject in question. This growth also signifies an increasing interest in the subject matter on the part of researchers.

The fact that the question of quality of explanations contained in corporate governance statements has been noticed is also seen in actions undertaken by the European Union. In response to the perceived problems, the European Commission issued Commission Guidelines on Corporate Governance Reporting Quality in 2014. These efforts on the part of the European Union are a reaction to the concern expressed by practitioners, who claim that company statements are not always in line with the reality, and that the quality of the explanations they contain is also questionable (e.g. Koładkiewicz, 2014).

In conclusion, it is important to stress the practical dimensions of the paper's analysis of the quality of explanations for failure to apply principles of corporate governance (in whole or in part). Its results may prove useful to participants of the capital market, including the recipients of corporate governance statements, the developers of Corporate Governance Codes, and policymakers monitoring the capital markets of their respective countries. The practical application of these results may become an important step in building transparency in companies, which is a foundation for effective functioning of the capital market.

This paper is structured as follows: its first section contains an overview of the theories used to explain the phenomenon of corporate governance best practices as applied by companies. The second part sums up the results of research to date, i.e. research that has attempted to identify the quality dimensions of explanations concerning resigning from application of the principles of corporate governance in corporate governance statements. The paper is concluded with a summary encompassing an indication of the potential directions for further research.

Theories Explaining the Behaviour of Companies with Respect to Application of Principles of Corporate Governance

Principles of corporate governance (corporate governance codes or corporate governance best practices) have already become an inseparable part of the environment of companies listed on stock exchange (e.g. Burton, 2000; Aguilera and Cuervo-Cazurra, 2004; 2009; Seidl, 2007; Jerzemowska et al., 2010, Cuomo et al., 2016). The numerous codes established around the world in the wake of the Cadbury Code, the first European code published in Great Britain in 1992, confirm this statement. A total of 345 codes made their appearance up to the year 2014, including ninety-one first editions, where the remaining 254 were successive versions thereof (Cuomo et al., 2016, p. 225). In the case of the European Union, virtually all of its members have modified their corporate governance codes at least twice (the only exception being Slovakia).

Moreover, we can see an already high level of company declarations regarding the application of best practice in whole or in part. For example, in 2015 a total of 57% of FTSE 350 companies declared complete compliance with principles of corporate governance (Grant Thornton, 2015). This high level of declarations of compliance (with principles whose nature remains one of “soft” laws) leads to two crucial questions: Why do companies apply corporate governance best practice codes to such a great extent? What factors are behind the decision to apply them? The search for answers to these questions forms the central axis of research on the functioning of such documents. Among the main answers discovered in the literature on the subject there is a response to the results of profit and loss analyses involving application or non-application of the said principles by companies (Hooghiemstra and van Ees, 2011). For example, research shows that shareholders rate a greater level of compliance with principles positively (Goncharov et al., 2006). This assessment may translate into investment decisions (Hooghiemstra and van Ees, 2011). Among the economic dimensions of such analyses there is an assessment of the potential effects of application or non-application of the said principles in the area of reputation – i.e. to what extent compliance or non-compliance with corporate governance codes affects the company reputation (Karlsson-Vinkhuyzen and Vihma, 2009).

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Economic analyses of profits and losses related to application or non-application of corporate governance principles should also cover an analysis of agency costs (Aguilera and Cuervo-Cazurra, 2004). At the same time, it should be remembered that it is possible that the solutions proposed in corporate governance codes are simply technically unfeasible. In such situations, companies should explain why this is so as well as indicate the measures they are taking to resolve the problem. Luo and Salterio (2014, p. 462) state, “our findings suggest that firms are benefiting by creating governance practices that are cost efficient and effective for them given their firm-specific governance needs.”

Among the basic theories that could prove helpful in seeking answers to the above-mentioned questions, researchers involved in this subject matter point to legitimacy theory and institutional theory.

The basis of legitimacy theory is formed by actions taken by an organization to justify its right to exist and operate (Dowling and Pfeffer, 1975). According to Campbell et al. (2003), legitimacy theory is among the most broadly utilized theories serving to explain environmental and social disclosures. It also delivers a strategy of disclosures that organizations can take advantage of in order to legitimize their existence (Gray, Kouhy, and Lavers, 1995). The relations between an organization and its audience are at the centre of attention of legitimacy theory. They are assigned a key role by Suchman (1995). He sees them as key factors for an organization acquiring legitimacy as opposed to its structures or actions (Suchman, 1995, p. 594).

However, it should be remembered that legitimacy itself is a source of restrictions for every organization. Its scope and impact are extremely diverse. The determinants in this case include the level of visibility of the organization as well as the degree to which it is dependent on its environment and stakeholders (Dowling and Pfeffer, 1975). In the case of listed companies, both dimensions are very important. The regulatory environment in which they operate imposes requirements upon them that guarantee transparency of actions to other participants of the capital market. The effect of imposition of the said requirements is a significant growth in visibility as compared to organizations from outside the stock market. Moreover, organizations operating on a regulated market are much more dependent on the approval of their activities by their environment, which translates into their increased involvement in activities tying them with that environment and building good relations with it (Dowling and Pfeffer, 1975). In the case of listed companies, such activities undoubtedly include the way in which the principle of “comply or explain” is implemented. The importance of this principle grows particularly in situations in which the best practice found in corporate governance codes is not adhered to. Organizations are generally expected to provide explanations for behaviour that deviates from institutionalized expectations in order to preserve their legitimacy (Hooghiemstra and van Ees, 2011).

A company's corporate governance statement which contains explanations as to any deviations should be perceived as one of the key activities aimed at acquiring a desired level of acceptance in the company's corporate governance sphere. The statement's quality determines its level of approval among shareholders and investors, and ultimately forms the basis for the company to maintain its legitimacy. In this context, the primary benefit stemming from application of corporate governance codes from a company's perspective is the maintenance of the company's current level of legitimacy (Enrione et al., 2006, p. 968; Hooghiemstra and Van Ess, 2011). Explanations related to non-application of a principle or principles of corporate governance as contained in a corporate governance statement can also be treated as a legitimacy tactic used by companies (Seidl et al., 2013).

At this point it should be emphasized that a decision not to apply principles of a corporate governance code is not an instance of bad practice. What bad practice most definitely is, however, is failure to provide information as to non-compliance or lack of explanations clarifying such behaviour on the part of the company. The idea behind corporate governance best practices is grounded in the company's possibility to make a choice, which to a great extent is determined by internal factors. This flexibility should allow companies to develop solutions in the area of governance that not only satisfy shareholders, but also meet the needs of a given company itself. Subject to given conditions, the solutions suggested by a company may prove more efficient in terms of cost as well as more effective than anything provided for by corporate governance codes. Thus, a company's decision to take advantage of the "explain" option may potentially bring greater benefits than the "comply" option. This has been confirmed by the results of research by Luo and Salterio (2014). However, a basic condition for this to be true is the right quality of the explanation provided by the company. Full and comprehensive information is undoubtedly the key to win the favour of shareholders with regard to actions taken by the company in the area of organization as well as reorganization of its corporate governance system.

A second theory used to explain the approach of companies to corporate governance codes is the abovementioned institutional theory (DiMaggio and Powell, 1983). Its assumptions are particularly useful in understanding the phenomenon of company's application of principles contained in corporate governance codes in spite of the fact that their character is that of a "soft" law, which means there are no legal sanctions for the lack of application thereof. An analysis of the range of application of these documents by companies proves they are widely approved (at least on a declarative level), which makes companies similar to each other (e.g. EcoDa, 2015). What institutional theory does is try to explain the phenomenon of companies becoming more alike, i.e. their increasing homogeneity (DiMaggio and Powell, 1983). This process of homogenization is defined as an isomorphism that, in line with Howly's definition, "is a constraining process that forces an entity in the population to be similar to other entities that are active in the same environment" (DiMaggio and Powell, 1983, p. 439). Since corporate governance codes are already an important element of the environment of listed companies, new companies entering the stock market cannot ignore their existence. Not wanting to differ too much from the current players, stock market newcomers declare application of corporate governance codes as they want to be like companies that are already present on the market (EcoDa, 2015). This approach is fostered by the rather widespread view that investors and other capital market participants tend to expect application of corporate governance codes rather than explanations regarding any deviations. A similar trend involving attempts to be alike that expresses itself through the application of corporate governance practices (both on a declarative and real level) can also be seen in the case of major listed companies (EcoDa, 2015; Hooghiemstra and van Ees, 2011).

The homogenization of companies in the area of corporate governance code application may be seen as a response to uncertainty, which is a basis for mimetic isomorphism resulting from standard responses to uncertainty (DiMaggio and Powell, 1983). Mimesis understood literally is a type of defensive behaviour (protection, camouflage) involving mimicry of one's surroundings (Rosińska, 2008). According to DiMaggio and Powell (1983), uncertainty is a significant force that encourages an organization to assume a defensive position in the form of imitation. Such behaviour usually comes from an awareness of a lack of sufficient information to undertake independent action (Rosińska, 2008). In the case of listed companies, the basis for applying the principles of corporate governance codes (in whole or in part), and, therefore, in imitating each other, is companies' realization that they lack sufficient information concerning the reception of their behaviour among their shareholders. The very significant level of uncertainty in this context is determined by that fact that dispersed ownership structures are only marginally predictable, where shareholders undoubtedly make up a group that is insignificantly organized and unstructured (Hooghiemstra and van Ees, 2011).

The progressing mutual resemblance of companies expressed in their willingness to apply corporate governance codes may also take on undesirable forms such as one company's inclination to copying explanations clarifying instances of non-compliance with best practices as developed by other companies. The driving force behind such actions is the uncertainty as to how a company's shareholders will react to the explanations it offers. This uncertainty also encompasses how explanations are formulated. Copying explanations, especially those provided by companies that are known on the market and those that have already been approved by such companies' shareholders, creates a certain sense of safety, especially when the explanations offered by the company for acts of deviation have already received an approval of its shareholders (Shrives and Brennan, 2015).

The Quality of Explanations for Non-Application of Corporate Governance Principles: Dimensions of Analysis

The results of analysis related to experience combined with the functioning of corporate governance codes to date indicate that the main challenge is not to convince companies of the need to apply these codes. The real challenge is to guarantee transparency for shareholders and potential investors regarding the provision of information by a given company as to its application or non-application of best practices as contained in such documents. According to Commission Recommendation of April 9, 2014 on the Quality of Corporate Governance Reporting (2014/208/EU, hereinafter referred to as Commission Recommendation 2014/208/EU), information contained in statements regarding the application of corporate governance principles should be "sufficiently clear, accurate and comprehensive." Thanks to this, such statements should provide capital market participants with an understanding of how the corporate governance system works in a given company (Section II, item 5). Such information should be found in the statement on applying corporate governance principles that, in line with the provisions of Directive 2013/34/EU of June 26, 2013, should be attached to the annual financial statement[4]. However, the Directive does not define any minimum quality for explanations included in the statement. Similarly, Commission Recommendation 2014/208/EU does not contain any categories making measuring of the quality of explanation possible.

The quality of explanations contained in company statement on departures from (all or some) corporate governance principles is a reflection of this approach to corporate governance. Explanations of deviations that are satisfactory to shareholders are a proof of good governance being in place in a given company (Grant Thornton, 2011). The basic pillar of such satisfaction among shareholders and potential investors is the guarantee

[4] The first time that the requirement for listed companies to include a corporate governance statement in their annual reports appeared was in Directive 2006/46/EC. It was reiterated in Directive 2013/34/EU of the European Parliament and of the Council of June 26, 2013.

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of transparency of company activities. Information provided by the company is the key to building this pillar, where a significant role is played by information policy related to application or non-application of corporate governance code principles.

Considering the significance of the quality of explanations contained in a corporate governance statement as well as making efforts at guaranteeing the desired quality are important elements of the process of improving the effectiveness of the functioning of corporate governance codes. A key challenge for capital market stakeholders that must be faced in this area is defining the quality dimensions of explanations regarding the non-application of corporate governance best practices. Prior to presenting the results of efforts at meeting this challenge to date, the following two questions need to be posed: Is it at all possible to define the dimensions in which the quality of explanations should be expressed? Is it possible to assess the quality of explanations offered by companies? It must be remembered that explanations are addressed to companies' shareholders, and they are the ones who decide whether or not they are satisfied with them. Does the company offer the expected transparency thanks to these explanations? Do the processes and phenomena taking place in the corporate governance sphere become understandable to shareholders and do shareholders approve of them?

At the same time it must be remembered that the complexity of the matter of assessing the quality of explanations grows in line with the dispersal of ownership structures. Shareholders are not particularly organized and form an unstructured group that is characterized by wide-ranging variation in terms of the needs and expectations with respect to company they hold shares in. An important factor in this differentiation is shareholders' knowledge about the company, including its needs in the realm of corporate governance as well as its practices applied in practice. This translates into a multiplicity and diversity of factors determining the approval or rejection of explanations related to deviations as offered by a given company. However, bearing in mind the need for ensuring transparency of actions for shareholders, guidelines formulated by the participants of FRC 2012 can be assumed as forming the basic pillars that the company should rely on. Thus, explanations should be "relevant, specific and sufficiently informative" (FRC, 2012, p. 6). Unfortunately, these recommendations are characterized by a high level of generalization, and specification thereof is certainly not an easy task. The phrase "sufficiently informative" itself ushers in significant difficulties. The reason is the varied level of shareholders' knowledge regarding the company and its needs in the area of governance. In the end, what is common knowledge for some, is not necessarily so in the case of others. A useful indicator in undertaking actions in this sphere may be a suggestion offered by one of the participants of an FRC meeting concerning the quality of explanations. According to that participant, an explanation should provide "enough information to those shareholders who could not simply pick up the phone and talk to the company" (FRC, 2012, p. 6).

The assumption that an explanation for deviation should be "relevant, specific and sufficiently informative" (FRC, 2012), or, as stated by the EU, "sufficiently clear, accurate and comprehensive" (Commission Recommendation 2014/208/EU) may act as a starting point for defining the quality dimensions of the explanations offered by companies. The results of efforts made to date at defining the said dimensions as presented below is a successive brick to bridge the knowledge gap in this field. Prior to the presentation of these results, it is necessary to bring to mind just what such an explanation should contain. According to the European Union's Green Paper, basic information that an explanation should encompass includes (The Green Paper, paragraph 3.1):

- An indication of the principles that the company does not adhere to,
- Reasons for not applying them,
- An indication of the solution that was applied instead, and
- Information as to whether this noncompliance is permanent or temporary.

Among the first efforts aimed at evaluating the quality of explanations related to a company's non-application of corporate governance code principles are the results of an analysis commissioned by the European Union, that were presented in 2009 in the Risk Metrics Report (RiskMetrics, 2009). The core of this evaluation was the information content of the explanation. On the basis of the performed analysis, 1,141 deviation explanations were assigned to five categories (RiskMetrics, 2009), namely:

1. Invalid – A case when a company only informs of a deviation, but fails to provide explanations.
2. General – When a company declares an overall lack of approval of corporate governance best practices, and simultaneously does not provide any other potential solutions.
3. Limited – When a company does not explain the reasons for its non-compliance, but does provide information regarding alternative solutions or procedures thanks to which it intends to achieve the same goal as the principles found in the corporate governance code.
4. Specific – When a company describes its specific conditions and explains why it is impossible to fully apply the relevant corporate governance principles.
5. Transitional – When a company indicates the principles from which it currently deviates, but will apply in the future.

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Looking for the presence of key elements that explanations for deviations should contain when assessing information content applying the above categories of explanations, we can see that a subdivision into those that are "informative," provide "limited information," or are "uninformative" is possible. The first three of the abovementioned categories can be defined as providing limited information or as being uninformative. The significance of the problem of explanation quality is substantiated by the fact that the explanations were incomplete in terms of information that was dominant in the group of the analysed explanations. Only 39% of the analysed explanations were classified as meeting information requirements. It is worth adding that the highest level of information was contained in statements of companies from France, the Netherlands, Sweden, and Great Britain (RiskMetrics, 2009).

Seidl, Sanderson, and Roberts (2013) follow a similar path in their search for quality dimensions of explanations for deviation and assessing information content. It was on the basis of their research that they proposed a three-element taxonomy of explanations as offered by companies. Their taxonomy includes (Seidl et al., 2013):

- Deficient justification,
- Context-specific justification, and
- Principled justification.

Explanations belonging to the first of the identified categories, i.e. deficient justification, only contain information regarding a company's non-application of a given principle. Thus, they leave shareholders in ignorance as to why this is the case. Moreover, it is not known if the company intends to take any action in order to develop its own set of best practices. The second identified category, context-specific justification, covers explanations as to the reasons for instances of deviation. The source for such explanations is the company-specific features and characteristics, such as the company's size, structure, the international context of its activities, its sector of operation, etc. The third of the identified categories involves explanations that indicate that in the case of a given company, a certain principle of corporate governance cannot be considered best practice as a result of conditions faced by the company, where application of the said principle might result in additional costs. A more in-depth characterization of particular categories and subcategories is given in Table 1.

Table 1. Explanation Categories and Subcategories based on the Seidl, Sanderson and Roberts Taxonomy (2013)

Category/Type of Explanation	Definition	Subcategories	Other
Deficient justification	A company confirms it has not complied with a code provision, but does not provide reasons for deviating from the corporate governance code.	Three subcategories: 1. Pure disclosure – The company merely declares that it is deviating from particular code provisions. 2. Description of alternative practice – The company presents an alternative solution, but does not provide any justification for it. 3. Empty justification – The company gives an explanation that seems like a justification for its deviation, however, it does not offer any explanatory power.	Such deviations may be either temporary or may persist over time. Such deviations undermine the functioning of the self-regulatory code regime and will eventually require action to be taken by the regulator.
Context-specific justification	A company provides explanations for non-compliance that are fully justified, where compliance is either inappropriate/irrational or impossible.	Six subcategories, related to: a) Company and/or board size, b) Company structure, c) International context, d) Other company specific reasons, e) Industry specificities, and f) Transitional issues (new code provision or new entrant).	Company justifies deviation with reference to its specific situation.
Principled justification	A company justifies deviation with reference to problems with a specific code provision. A company contends that a provision does not reflect best practice.	Three subcategories: 1. Effectiveness/efficiency issues, 2. General implementation issues, and 3. Conflicts with other laws/standards.	

Source: own work on the basis of Seidl, Sanderson and Roberts (2013).

Shrives and Brennan (2015) offer a more complex and, therefore, multidimensional attempt at defining quality dimensions in explaining deviations from corporate governance code. They have identified seven dimensions of analysis meeting their needs:

1) Location,
2) Comprehensiveness,
3) Originality/mimetic behaviour,
4) Length,
5) Complexity,
6) Specificity, and
7) Attestation.

Table 2 contains detailed characteristics describing the abovementioned dimensions.

Table 2. Explanation Quality Assessment Categories as Proposed by Philip J. Shrives and Niamh M. Brennan, Including Basic Characteristics

Category	Description
Location	Three key subcategories have been identified: A) Deviation explanations making up a part of a corporate governance statement and given: 1. At the beginning, 2. In the middle, or 3. At the end. B) A situation in which there is no corporate governance report, where explanations are found in other parts of the annual report and are difficult to locate for this reason. C) The explanations for deviations are dispersed throughout the entire corporate governance statement or annual report.
Comprehensiveness	The comprehensiveness of deviation explanations has been assessed in accordance with the following five subcategories: 1) Full explanation of noncompliance: code principle labels (e.g. A.2.1) with customized explanations (best), 2) Explanation and code principle labels disclosed, but not always together, 3) Explanation with no code principle indication, 4) Code provision principle with no explanation for non-application, and 5) Code principle labels that appear to be incorrect (worst).
Originality/mimetic behaviour	Assessment of the extent to which it seems that the company has copied explanations of other companies in relation to duality.

Length	This category encompasses six subcategories identified on the basis of the number of words contained: 1) 100–199 words (probably the "best" subcategory providing a full and detailed explanation), 2) Over 200 words (too long and for this reason probably not ideal), 3) 60–99 words, 4) 30–59 words, 5) 15–28 words (too short), and 6) Less than 15 words (definitely too short).
Complexity	This category has two components: 1) Legibility and 2) Use of passive voice, which emphasizes the risk that non-compliance will be attributed to no one in particular and thus readers are unlikely to know anything about the processes that have led to non-compliance.
Specificity	Three subcategories have been created for the needs of this category: 1) A specific explanation – Delivers details regarding non-application of corporate governance principles, and contains the reasons for it, which is important in the context of specific conditions faced by the company (best), 2) A general explanation – May be used by various companies and does not strive to make reference to specific company conditions that may be responsible for instances of non-compliance, and 3) An unsatisfactory explanation – Encompasses situations in which non-application of a principle of corporate governance code is indicated, but no reason is provided and there is a lack of any explanation thereof whatsoever.
Attestation	This category examines the extent to which auditors see an absence of application of corporate governance code principles as well as of company explanations for this and its inclusion in reports. Due to the approach of auditors, it is most probable that their reports will remain unmodified regardless of the absence of application of corporate governance code principles.

Source: own work on the basis of Shrives and Brennan (2015).

Shrives and Brennan have also formulated proposals for the structure and the content of explanations for deviation from corporate governance code principles on the basis of the received results. In their view, they should include (Shrives and Brennan, 2015, p. 97):

- A clear indication of the principles that the company does not adhere to,
- A brief summary of the principle deviated from,
- A detailed and lucidly written explanation that is adequate with respect to the company's situation and that contains the reasons for non-compliance,

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- Information regarding the extent to which measures taken with regard to a given principle guarantee good governance, and
- An indication as to whether there are plans to apply the principle at some point in the future.

In addition to the abovementioned proposal for the structure and the content of explanations, Shrives and Brennan have also suggested potential measures that a company should take in order to improve transparency with respect to shareholders. Thus, a compliance statement should (Shrives and Brennan, 2015, p. 97):

- Be easy to identify, where the best solution in this area is to indicate which principles the company does not apply right at the beginning of the corporate governance statement,
- Contain details related to non-compliance, i.e. non–application of the principle together with an explanation thereof,
- Contain an appropriately detailed explanation so that shareholders can assess non-compliance justifiability on its basis, and
- Be specific for the company, meaning it should provide the reasons for which non-compliance is justified and adequate with respect to the needs of the company.

Two approaches may be highlighted in summarizing the proposed methods for assessing the quality of explanations for non-compliance with corporate governance principles (in whole or in part). The first suggests subdividing explanations into categories (the proposals of RiskMetrics, 2009 and Seidl et al., 2013) that are, in fact, a reflection of company policy related to corporate governance code application, such as:

- The company does not apply corporate governance principles, but informs of this fact and explains why this is the case (where this lack of application, permanent or temporary, is a result of the specificity of the company), or
- The company does not apply corporate governance principles and merely informs of this fact without explaining why this is the case.
- In addition to these variants of company behaviour, two other ones may be identified:
- The company provides information that it applies corporate governance principles whereas it does not do so in practice (most negative variant), and
- The company provides information that it applies principles of corporate governance and does apply them reliably in practice (most positive variant).

The last variant involving a complete lack of explanation, combined with non-application of corporate governance codes, should become a thing of the past in the light of the coming of Directive 2013/34/EU into force.

The second approach to assessing explanations of deviation from corporate governance principles is covered in the aforesaid proposal offered by Shrives and Brennan (2015). The proposal offers a multi-criteria process enabling assessment in various dimensions (e.g. originality/mimetic behaviour, complexity, length). The assessment process as suggested by Shrives and Brennan (2015) goes farther than Commission Recommendation 2014/208/EU, which insists that the explanation for deviation be "sufficiently clear, accurate and comprehensive." Assessment criteria argued for by these authors indicate what should be subject to assessment while retaining a possibility to make an assessment that is relatively objective at the same time.

A common element linking the two discussed methods of assessing the value of explanations is the assessment of the information they contain. Depending on the extent to which the assumed criteria have been met, company explanations are spread over a continuum ranging from a completely exhaustive explanation through moderately exhaustive to not exhaustive. However, such an assessment does involve a subjective element, which stems from the needs of shareholders and potential investors, the recipients of the provided information. Depending on their knowledge about the company and corporate governance needs, their impression – and the following evaluation – of explanations in terms of transparency, accuracy, and exhaustiveness may vary.

The key stakeholders interested in assessment of explanations of deviation from principles of corporate governance (in whole or in part) should also be indicated in any overview of experience in these matters. In addition to the European Commission, this group includes authors of corporate governance codes[5] as well as all those who are interested in corporate governance. There are many factors underlying this consideration. The significance of explanations for deviation in the process of shaping company transparency should be deemed of primary importance. Reality shows, however, that some companies do not approach this as they should (e.g. the findings of the RMG Study show that over 60% of explanations given by companies were insufficient, Keay, 2014). Another problem is the lack of any institution monitoring

5 Depending on the country, authors of principles of corporate governance may vary. For example, I. Ferrero and R. Ackrill (2016, p. 885) distinguished the following types of code issuers: stock exchange issuers, government issuers (national legislature or government commission), industry or trade association issuers, and composite issuers, with representatives from at least two individual issuer types.

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the quality of such explanations – as well as of the corporate governance statements themselves. For example, many European Union member states have no regulatory/monitoring authority overseeing compliance and verifying whether given explanations are adequate (e.g. Keay, 2014). At this point it should be also recalled that Shrives and Brennan (2015) have already noticed this problem. They offered attestation as a criterion in assessing the quality of explanations of deviation from corporate governance codes. Its application signifies involvement in the assessment of the quality of explanations by company auditors.

Summary

The analysis conducted for the purpose of this paper on suggested methods of assessing the quality of explanations for deviations from principles of corporate governance as provided by companies listed on the stock exchange shows that in spite of numerous efforts made, this is, in fact, the beginning of the road leading to the objective of creation of an effective mechanism for assessing and evaluating such explanations. Regardless of the fact that the weight of the problem of the quality of explanations has been noticed by participants of the capital market, European Union institutions, and researchers alike, the volume of efforts taken at identifying the dimensions in which this quality should be expressed is far from impressive at present. However, the key dimensions that should be subject to assessment can be identified on the basis of the results of studies conducted to date. Without a doubt, the primary pillar is the quality of information found in explanations for shareholders. It is this quality that determines if the shareholder understands the processes occurring in the realm of corporate governance in a given company. Are they transparent to him or her? Does the shareholder understand the reasons behind actions taken and is he or she also aware of the effects that may be their outcome for both the company and for the shareholder? Is he or her capable of undertaking a decision that is adequate with respect to personal investment needs on the basis of information contained in the explanations and in the corporate governance statement as a whole?

These efforts at isolating explanation types developed on the basis of the practice of companies to date indicate that it is possible to subdivide them into those that inform of a deviation from a corporate governance code, but do not provide the reason for such deviation, and those that do provide a reason, but one that diverges with respect to information completeness and value. The proposed categories of explanations correspond also to strategies assumed by companies with regard to principles of corporate governance.

In addition to the perspective of company shareholders, the current discussion points to a need for involvement of other capital market participants in the process of assessing the quality of explanations (e.g. Sergakis, 2013; Keay, 2014; EcoDa, 2015). The basis for this is the conviction that a more efficient monitoring of company activity in this area should translate into improved effectiveness of soft law as formed by corporate governance codes (Sergakis, 2013).

This discussion is currently focused on a search for answers to questions such as: Who should monitor the quality of explanations of deviations as provided by companies? Should special bodies be established to this end, or should this be the concern of capital market regulators? What role should institutions involved in developing corporate governance codes (i.e. their successive versions) play in the evaluation process? What level should this monitoring be applied at? Should it encompass an assessment of the quality of an explanation, or should it restrict itself to only stating its presence or absence? Should an absence of an explanation of deviation be penalized and, if so, in line with what principles? What power should the monitoring body have with respect to companies – and should it have any power whatsoever (e.g. Keay, 2014)? A question worth adding to this list is one about the role of the board of directors/supervisory board: What role should it play in the process of developing an explanation?

The above questions indicate the potential directions of further research aimed at exploring the knowledge and understanding of the phenomenon of the "comply or explain" mechanism as applied in practice. This, according to many researchers, continues to be still insufficiently investigated (e.g. Aguilera and Cuervo-Cazurra, 2009).

Coming back to the matter of the quality of explanations related to company's application of principles of corporate governance, it should once again be stressed that such explanations form an important element of company information policy — building company transparency for shareholders as well as for other stakeholders in the capital market. Transparency in company activities is the foundation for building trust among a given company's shareholders – mainly trust in the top management in charge of it. The approach of the top management to the principle of "comply or explain," especially in terms of formulating explanations for deviation, is among the factors prerequisite to the presence of trust between the company and its shareholders. In this context, a company or its top management limiting itself to merely informing of a lack of application of a given principle of best practice without a full explanation of the reason for such behaviour does not foster trust. In fact, such approach may have an opposite effect and lead to a threat of loss of trust. The Financial Reporting Council (FRC, 2012) sees an even broader context to the problem of poor care on the part of companies as

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to the quality of explanations for deviations from corporate governance standards. It states that "failure to provide an adequate explanation increases the risk not only of the company being perceived as acting illegitimately, but also of the code being seen as lacking legitimacy" (FRC, 2012). This can ultimately lead to a weakening of the power, or authority, of such codes. It is for this very reason that the efforts taken with the intention of guaranteeing the desired quality of explanations for deviations are among the most important challenges that the capital market must currently face.

In conclusion, it must be stated that the analysis of the problem of the quality of explanations as presented in this paper is an introduction to the issue in question. It should be treated as a starting point for further research into solutions satisfying the information needs of stakeholders on the capital market. Such quest may begin with answers to the abovementioned questions. A potential exploration of the problem should also take into account the experience stemming from the practice of applying explanation assessment proposals as developed and presented in the paper. The paper may also help policymakers in directing their actions at eliminating the weaknesses and deficiencies of corporate governance statements, bringing about an improvement in their quality.

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