

Legitimacy and Corporate Governance Determinants of the Disclosure of Executives' Share Rights, Options and Termination Benefits

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Abstract

This paper investigates an aspect of corporate disclosure that is personally sensitive to those responsible for the disclosure – namely, disclosure of remuneration for top executives in the form of share rights, share options and termination benefits entitlements from their company. The extent and nature of such disclosure is obtained from the content analysis of annual reports of 191 Australian listed companies for the years 2003 and 2004. The main objective of this study is to provide evidence of the key determinants that influence managements' decision to voluntarily disclose details about their (mainly equity-based) remuneration. The years 2003 and 2004 were still largely unaffected by a detailed prescriptive regulatory environment for executives' and directors' remuneration disclosures, because the primary accounting standards, AASB 1046 and AASB 2 did not apply until 2005. The main focus of this study is to explain what factors (from legitimacy theory and corporate governance practices perspectives) influence managements' decisions about the extent of discretionary disclosure of executive remuneration. The hypothesized association between qualities of good corporate governance and executives' remuneration disclosures is tested by including measures of the ratio of executives on the board of directors and the existence of a remuneration committee. Further, the hypothesized association between legitimacy theory and executives' remuneration disclosures is tested by including measures of the existence or not of a recent AGM resolution to increase executives' remuneration, the size of the company, and recent media attention regarding corporate executives' compensation. Regression results reveal significant relationships between these determinants and the extent of disclosures of rights, options and termination benefits of executives. These results suggested that under a relatively unregulated environment, corporate management will react to community and shareholders' expectations by revealing personally sensitive information when their company is placed in a situation of higher shareholder and public scrutiny and when it is structured to meet expectations of good corporate governance. This study makes a contribution to the accounting literature by advancing the understanding of the interface between voluntary disclosure of personally sensitive information and both corporate governance structures and companies' legitimation incentives.

Key words: Executives' remuneration, equity-based compensation, corporate disclosure, legitimacy theory, corporate governance.

1. Introduction

Equity-based compensation to corporate executives and directors has attracted much attention in the last two decades. There has been growth in the practice of providing performance incentive payments to top executives in the form of company share rights and options rather than cash bonuses. Share options are the fastest growing component of CEO compensation in the US (Core, Guay and Larcker (2001).

Aboody, Barth and Kasznik (2004) would say that this practice has been popular because compensation to executives by the issue of shares or share options would be accounted for in equity and would by-pass reported profit (at least prior to 2005 when AASB 2 'Share-based Payment' will become effective), whereas compensation by a cash bonus would be accounted for as an expense and be a profit-reducing accounting method.

In surveys of executive compensation, Murphy (1999) and Core, Guay and Larcker (2001) identified the greatest concern of shareholders as the degree to which executive compensation aligns top executives' interests with those of their shareholders. Much of the empirical research in accounting has applied principal-agency models to explain the incentives on executives of alternative types of compensation (Bushman and Smith, 2001). This group of studies addressed how the structure or specific compensation plans impact on management decision-making regarding resource allocations and corporate performance. For example, there is considerable evidence to show that the sensitivity of pay to performance in the US has increased over time, and the vast majority of this sensitivity comes through executive ownership of common stock and of options on common stock.

The body of research evidence on the relationship between the general structure of executive remuneration and corporate performance has become large. In contrast, there is a lack of evidence about the extent to which corporations are prepared to publicly disclose details about their executives' remuneration contracts or packages and annual changes in the values of entitlements and payouts under these packages. Murphy (1999) and Hall and Leibman (1998) suggest that there has been on-going

concern from shareholders that share-based entitlements are managed opportunistically by managers in order to maximize their own rewards ahead of those of shareholders. Additionally, there has been a high degree of publicity about payouts to terminating CEOs - e.g., in Australia, the payouts for failed CEOs of NAB (Bolt, 2004) and James Hardie Group (Charles, 2004). The indication is that there has been growing interest from shareholders and the public in disclosures about executives' share rights, options and termination entitlement. Yet, it is surprising that more research has not been undertaken on the factors that influence managements' decisions to voluntarily disclose or withhold disclosure of details about their remuneration.

The objective of this study is to first provide evidence on the extent and nature of disclosure in company annual reports of information about executives' share rights, options and termination entitlement. The second, more substantial, objective of the study is to develop and test hypotheses about some key determinants that influence managements' decisions to voluntarily disclose details about their remuneration.

This paper will proceed by outlining changes in the Australian regulatory framework regarding executive and director remuneration disclosures that have occurred or been anticipated since 2003. It will then review the literature on the relationships between corporate disclosure and, respectively, legitimacy theory and corporate governance structures, from which hypotheses will be developed. The paper will then proceed to the empirical stage of variable measurement, sampling, data analysis and discussion of results.

2. Regulatory Framework in Australia

Today, the disclosure of share rights, options and termination benefits for directors and executives of publicly listed corporations in Australia is regulated by corporations law, Australian Stock Exchange (ASX) listing rules and accounting standards (AASBs). Most of these regulations became applicable in 2005, but had been anticipated since 2003. Hence, for the years chosen for this study, 2003 and 2004, much of the regulatory requirements had not come into force. However, some relevant

changes to the Corporations Act 2001 did have applicability for financial reporting periods ending on or after June 2004, and so are relevant for one year of this study.

While not enforceable in 2003 and 2004, the pressure on listed companies to disclose executive and director remuneration details on their annual reports came from the ASX's Corporate Governance Council. In March 2003 it issued a detailed document called 'Principles of Good Corporate Governance and Best Practice Recommendations'. The recommendations in this document were to apply from the first financial year commencing after 1 January 2003, hence are relevant to the annual reports of 2003 and 2004. This document did not represent prescriptions, but guidelines for corporations. Listed companies had the flexibility not to adopt the recommendations, but this flexibility was tempered with the requirement to explain why the recommendations have not been adopted.

To further explain the status of these ASX corporate governance guidelines, the ASX Listing Rule 4.10 requires companies to provide a statement in their annual report disclosing the extent to which they have followed the best practice recommendations of these guidelines in the reporting period. One of the recommendations – namely, *Recommendation 9 'Remunerate Fairly and Responsibly'* – expects that companies ensure a sufficient and reasonable level and composition of remuneration to top executives and directors, and that the relationship of this remuneration to corporate and individual performance is defined. To fulfill best practice with respect to *Recommendation 9*, the guidelines suggest that corporations provide disclosure about their remuneration policies so that investors can understand the costs and benefits of the policies, and the relationship between remuneration and corporate performance. Such disclosures are expected to relate to information about each director and each of the five highest-paid executive officers of the company.

The ASX guidelines go on to recommend that disclosures in the corporate governance statement should include the objectives of the remuneration policy and its relationship to company performance as well as information on the remuneration (both monetary and non-monetary) for each of the directors and five highest paid officers of the company. The recommendation is that remuneration details should contain information about termination and retirement payments, and the value of shares issued

or options granted (based on a recognised valuation method). These ASX guidelines have applied from the first financial year commencing after 1 January 2003, hence will have an impact on the annual reports of 2003 and 2004. Management still had discretion under these ASX guidelines to provide very minimal and general disclosure about remuneration policy only, to provide some aggregated details about remuneration entitlements and valuations, or to provide comprehensive details on each individual executive's and director's remuneration entitlements, valuations and payments received.

An obviously enforceable source of the regulation of executive remuneration disclosures is the *Corporations Act 2001*. In 2004, the CLERP 9 proposals were adopted as revisions to the Corporations Act and involved expanded disclosures for executive and director remuneration. But these CLERP 9 amendments to the Act were made applicable to financial years commencing on or after 1 July 2004. Therefore the expanded disclosures are not applicable for financial years ending in 2003 or 2004 – the years of this study.

However, the *Corporations Act 2001* did contain some relevant disclosure requirements prior to the inclusion of CLERP 9. Compliance with these requirements would apply in the financial statements ending in 2003 and 2004, but are the same for each of these financial years. This Act prior to CLERP 9 amendments required, in relation to the top five executives of the company, disclosure in the directors' report of options that are granted over unissued shares or unissued interests during or since the end of the reporting year. In addition, the previous Act required that disclosure must be made of unissued shares under option at reporting date and shares issued during the year as a result of exercising options. Details required in this section (s.300) do not have to be in the director's report if they are included in the financial statements.

The third major source of regulation of disclosures on directors' and executives' remuneration is the Australian accounting standards. Two relevant accounting standards concerning directors' and executives' disclosures were in existence for the 2003 and 2004 years. They were AASB 1017 '*Related Party Disclosures*' and AASB 1034 '*Financial Report Presentation and Disclosure*'. However, these standards

require limited disclosures of directors' and executives' remuneration relating specifically to share rights, options and termination payments. They require numbers and dates of share rights and options granted to directors and the top five executives, but not valuations. Also, no mention is made of disclosures of termination benefits.

The major impact of accounting standards in the study period has taken the form of the *anticipation* of AASB 1046 'Director and Executive Disclosures by Disclosing Entities'. AASB 1046 was issued in January 2004 but its operative date was amended to apply to annual reporting periods beginning on or after 1 July 2004. Hence, compliance actually took effect in 2005 annual reports. Initially, AASB 1046 was to be operative for annual reporting periods ending in 2004. But after its postponement to 2005, early adoption in 2004 was still permitted. So the effect of *anticipation* of AASB 1046 on discretionary disclosures in 2004 is expected to be strong. AASB 1046 includes considerably more extensive disclosures than the prior accounting standards. These disclosures are to be disaggregated to each component of remuneration for each specified director or executive, not just banded disclosures. They are to include primary remuneration, post employment entitlements, equity compensation and other benefits. Aggregates must also be disclosed. Share-based payment compensation is to be disclosed in a manner reflecting the requirements of the new A-IFRS AASB 2 'Share-based Payment', which requires the valuation of share issues and options granted to executives.

Thus, overall, although some disclosures were mandated in 2003 and 2004 through the Corporations Act 2001 and existing standards AASB 1017 and AASB 1034, these were quite minimal requirements. The encouragement to provide discretionary disclosures in 2003 and 2004 would have been given by the ASX corporate governance guidelines. A more prescriptive encouragement to provide discretionary disclosures was present in 2004 due to the strong *anticipation* of the extensive disclosure details that would become enforceable in 2005 when AASB 1046 was to become operative.

3. Literature and Hypotheses on Legitimization and Discretionary Disclosure

There is a wide body of literature that has used legitimacy theory to explain incentives for corporate voluntary disclosures (Perrow, 1970; Dowling and Pfeffer, 1975; Meyer and Rowan, 1977; Ashforth and Gibbs, 1990; DiMaggio and Powell, 1991).

Legitimacy theory, from an institutional viewpoint, posits that organisations, managers, performance measures and audience needs are components within a 'larger, institutionalised cultural framework' that produce demand for each other (Suchman, 1995). Suchman (1995) defines legitimacy as "a generalised perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed systems of norms, values, beliefs and definitions." As explained by Wilmschurt and Frost (2000), underlying the notion of corporate legitimacy is a view that stakeholders within the community deliberate on those corporate activities which are acceptable, whereas corporations, as members of that community, are expected to carry out their activities within the boundaries of what is deemed acceptable by that community. Legitimacy is achieved when organisations adopt proper organisational structures and practices that comply with social norms or values (Meyer and Rowan, 1977). Stakeholders that are affected and satisfied by the legitimacy of organisations will assist organisations' activities and entitle them to utilise resources (Elsbach and Sutton, 1992).

Business operations face on-going change, as do the needs and expectations of stakeholders and society. Therefore, corporations have to manage their strategies and practices in order to retain their perceived legitimacy. Problems arise when organizations become out-of-date with societal values and understandings, or are confronted by a multiplicity of stakeholders with ambiguous, conflicting and inconsistent demands and different interpretations of what are the most appropriate organizational structures and practices (Wilmschurt and Frost, 2000). The studies of Pattern (1992), Deegan (2002) and Ogden and Clarke (2005) identified a range of strategic postures employed by managers (involving assertive, tactic and defensive techniques) to manage stakeholders' perceptions. In particular, an important tactic is to increase voluntary disclosure in their company's annual reports in response to, or in anticipation of, threats from stakeholders or the public to the company's legitimacy.

Several prior studies have focused on annual report disclosures in response to an event causing a threat to a company's legitimacy. For example, Patten (1992) invoked legitimacy theory to explain the effect of the Exxon Valdez oil spill on increases in annual reports disclosures by petroleum firms other than Exxon. He concluded that "it appears that at least for environmental disclosures, threats to a firm's legitimacy do entice the firms to include more social responsibility information in its annual reports" (Patten, 1992, p. 475). Hutchings and Taylor (2000) also used legitimacy theory to interpret their findings that both BHP and other mining companies operating within Australia and Asia greatly increased their environmental disclosures in annual reports following the announcement of the OK Tedi River pollution lawsuit against BHP.

It is speculated that events causing a potential threat to a company's legitimacy might include the following:

- Revelation to shareholders of a company cover-up about excessive increases in equity-based payments to executives;
- Publicity about an excessive termination pay-out to a failed CEO and other top executives.

To repair legitimacy when the company's position is threatened by withdrawal of resources by providers, management will seek to re-establish its credentials through the disclosure of additional information (Wilmshurt and Frost, 2000), particularly to provide positive interpretations of controversial actions (Arndt and Bigelow, 2000). These interpretations involve impression management tactics as a means of portraying organizational policies and actions in ways that are intended to secure endorsement and support from shareholders and the community. Hence, greater disclosures on executive remuneration policies and justifications for remuneration increases, together with a strategy of transparency about the extent of executive remuneration, could be an important impression management tactic. Industry or securities regulator codes of best practice that has been issued in many countries around the world typically contain a recommendation about making executives' remuneration package on boards more transparent to stakeholders. Hence, societal norms have shifted towards expecting transparency from executives and directors about their personal remuneration from their company.

In several areas of reporting (especially environmental and social responsibility activities, corporate governance structures and risk management mechanisms), managers have increasingly gone beyond the legal requirements for reporting financial information to shareholders (Gibbons et al., 1990; Patten, 1992; Arrington and Francis, 1993; Hopwood, 1996; Brown and Deegan, 1998; Buhr, 1998; Neu et al., 1998; Deegan, 2002) for legitimation reasons. Legitimation by way of managing the activities examined by the public eye will help to improve companies' public status in its social network (Odgan and Clarke, 2005).

Circumstances that point to the presence of a greater need for management to engage in legitimation through discretionary disclosures of executives' share rights, options and termination/post-employment benefits could include:

(i) When a company has received media attention, especially when it is specifically named in the press, in relation to the remuneration packages of its executives and directors, it is likely to react by publicly providing its own information about the topic being publicised. Again, this disclosure of information through its own reporting outlets, particularly its Annual Report, is a legitimacy management tactic. Hence, the more media attention relating to executive and director remuneration that a company receives within a year, the more incentive management will have to ensure additional (discretionary) disclosure on this matter in the company's Annual Report. Such reasoning leads to the formulation of the following hypothesis:

H1: The higher the media attention during the year on executive remuneration provided by a company, the greater will be the extent of disclosure of executives' share rights, options and termination benefits in the company's Annual Report.

(ii) The existence of a proposal to increase executives' remuneration and, therefore, place this issue directly in the eye of the shareholders. In those years when the Notice of Annual General Meeting (AGM) of the company includes an agenda item to grant more company shares or options to the CEO or other top executives, or to enhance their entitlements to termination benefits, then the shareholders (and the press) could

potentially view this AGM proposed resolution as representing excessive perquisites to management. Boyd (1994) provides many references from the business press and citations from chief executives that paying handsomely compromises an executive or director with the net results of having “destroyed his effectiveness”. Therefore, as a legitimacy tactic when an AGM resolution to increase remuneration is under scrutiny, management could increase the extent of disclosure in the subsequent Annual Report about aspects of executive remuneration. Based on this reasoning, the following hypothesis is formulated:

H2: The existence of a resolution to increase executives’ remuneration at a company’s AGM will positively impact on the extent of disclosure of executives’ share rights, options and termination benefits in the company’s Annual Report.

(iii) The size of companies, especially the largest listed companies in Australia, puts them under greater public scrutiny. For example, the payout to the former CEO of National Australia Bank received negative media and affected the public image of the bank (Bolt, 2004). This type of publicity can cause political costs to the company in the form of loss of customers and closer review by regulators such as ASIC. Large companies, therefore, have an incentive to give greater attention to legitimisation management. In order to manage the publicly sensitive matter of remuneration paid to executives and directors, the management of the largest companies would be expected to ensure that there is extensive disclosure in the Annual Report about their remuneration packages. From this reasoning, the following hypothesis is formulated:

H3: The larger the size of a company, the greater is the extent of corporate disclosure of executives’ share rights, options and termination benefits in the company’s Annual Report.

4. Literature and Hypotheses on Corporate Governance and Discretionary Disclosure

Jensen and Meckling (1976) apply agency theory to the modern corporation to model the agency costs of outside equity. In doing so, they formalize the idea that when

ownership and control of corporations are not fully coincident, there is potential for conflicts of interest between owners and managers. This conflict of interest, combined with the inability to costlessly write perfect employment contracts and/or monitor managers, will ultimately reduce the value of the firm to the owners. These ideas form the basis for research on corporate governance.

The interrelationships between board composition, executive compensation, and other corporate governance mechanisms have been widely investigated (Dennis and McConnell, 2001). Attention has been given to the influence of compensation packages on corporate governance effectiveness, board monitoring, and the structure of the organization. There is evidence that agency problems can be mitigated through the design of executive compensation contracts, coupled with certain corporate governance mechanisms, including the composition of board of directors (Pukthuanthong, Talmor and Wallace, 2004).

In relation to the composition of a board of directors, Hermalin and Weisbach (2001) review US evidence that a higher proportions of outside directors are associated with better decisions concerning such issues as company acquisitions. It is suggested that board effectiveness may depend upon outside directors. Fama and Jensen (1983) argued that outside board members who hold multiple directorships have a greater incentive to monitor corporate decisions because of their reputation as decision experts. Pukthuanthong, Talmor and Wallace (2004) contend that outside directors are more concerned with the company's compensation structure in the interest of shareholders to solidify their own reputation as competent and responsible board members. Other studies (Murphy, 1999; Chen and Jaggi, 2000; Cullen and Christopher, 2002; Eng and mark, 2003) have indicated that proportion of non-executive directors in board has influenced the independence of board, the transparency of annual reporting, the amount of executive compensation and the effectiveness of corporate governance.

However, the evidence has not been extended directly to findings about the influence of outside directors on the extent of disclosure of executives' and directors' remuneration in corporate reporting. Nevertheless, it is plausible to expect that outside directors, because of their need to protect their own high reputation with shareholders,

will be concerned to ensure that information about their compensation from the company and the compensation of top executives is made transparent to the shareholders. In particular, outside directors are more likely than executive directors to push for greater discretionary disclosures of equity-based remuneration and termination entitlements in the company's annual report to shareholders. Based on this reasoning, the following hypothesis is formulated:

H4: The higher the proportion of executive directors on the board of directors, the lower is the extent of corporate disclosure of executives' share rights, options and termination benefits in the company's Annual Report.

Another important corporate governance mechanism that would affect decisions by the board about executive and director remuneration is the establishment of a Remuneration Committee of the board. Corporate governance has been defined as a set of mechanisms – both institutional and market-based – that induce the self-interested controllers of a company (those that make decisions regarding how the company will be operated) to make decisions that maximize the value of the company to its owners (the suppliers of capital) (Shleifer and Vishny, 1997). One of these mechanisms is the formation of a Remuneration Committee that seeks to act in the interest of shareholders in considering policies for remuneration of executives and directors, including policies about keeping shareholders informed of such remuneration. A Remuneration Committee is likely to push the board and top executives to publish more rather than less information on executive and director remuneration in the company's annual report. This leads to formulation of the following hypothesis:

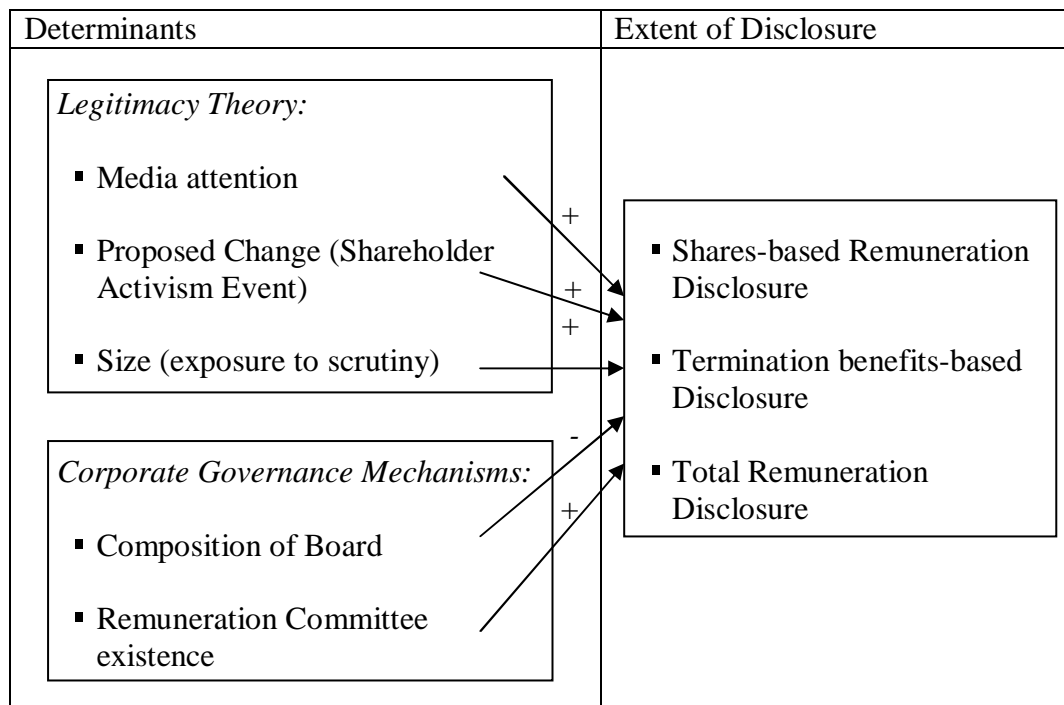
H5: When there exists a remuneration committee, there will a greater extent of corporate disclosure of executives' share rights, options and termination benefits in the company's Annual Report.

5 Methodology

5.1 Empirical Schema

The relationships developed in the five hypotheses can be depicted in an empirical schema. The theoretical perspectives underlying the relationships are legitimacy theory and the design of corporate governance mechanisms. These theoretical perspectives, the relevant constructs arising from these perspectives, and the hypothesised relationships that will be empirically tested are depicted in Figure 1.

Figure 1 Empirical Schema



5.2 Sample of Companies

To test the hypotheses, publicly available company data was collected. A sample size of 225 companies was initially selected randomly from the top 1000 Australian companies as reported in the *Business Review Weekly*, July 2004. Standardised financial highlights data was drawn from this BRW source, but the remaining data on the extent of disclosure of executive remuneration was drawn from full Annual Reports of listed companies using the *Connect4* electronic database. Because annual reports for 2003 and 2004 were not available for all companies, the sample was

reduced to 191 companies. For the two years sampled, the sample comprised 382 cases.

The profile of the final sample was that 129 companies (67%) were in the top 500 firms on the Australian Stock Exchange (ASX) based on total assets; 19 companies had multi-listing status and the remainder were solely listed on ASX; and the industry spread covered 10 industries based on the Global Industry Classification Standards (GICS). Table 1 shows the industry distribution of sample companies.

Table 1 Industry Distribution of Sample Companies

	Industry (GICS classification)	Number of Sample Companies
1	Consumer Discretionary	33
2	Consumer Staples	24
3	Energy	2
4	Financials	34
5	Health Care	11
6	Industrials	37
7	Information Technology	6
8	Materials	35
9	Telecommunication Services	5
10	Utilities	4
	Total	191

5.3 Variable Measurement

The definition and measurement of variables is listed in Table 2.

Table 2 Definition and Measurement of Variables

Variable Acronym	Definition	Expected Sign for IVs in relation to all DVs	Measurement
Dependent Variables			
DITOTAL	The extent of disclosure of share rights, options and termination benefits to executives		(number of words of disclosures regarding executive directors' share rights, options and termination benefits) / (no.of executive directors)
DISHARES	The extent of disclosure of share rights and options to executives		(number of words of disclosures regarding executive directors' share rights and options) / (no.of executive

			directors)
DITERMIN	The extent of disclosure of termination benefits to executives		(number of words of disclosures regarding executive directors' termination benefits) / (no.of executive directors)
Independent Variables			
MEDIA	Media attention on a company regarding executives' remuneration	+	The number of times during a year that a company's name is stated in relation to executive remuneration in the printed media
PROPREMUN	Proposal to the shareholders to approve a change in executives' remuneration	+	Existence of a resolution in the company's Notice of AGM regarding a proposed change to executive directors' remuneration, coded as 1 or 0.
SIZE	Company size	+	Log10 of total assets
BOARDINDEP	The composition between executive and outside directors in the membership of the Board of Directors	-	Proportion of executive directors to total directors on the Board of the company
REMUNCOM	Remuneration Committee of the Board of Directors	+	Existence of a Remuneration Committee in the company, coded as 1 or 0

As given in Table 2, the dependent variables measure the extent of disclosure of executive directors' share rights and options (DISHARES), termination benefits (DITERMIN), and the aggregate of these two (DITOTAL). The measure is based on the content analysis of relevant words and numbers in company Annual Reports. In line with the study of Brown and Deegan (1998), the number of words (and numbers that are counted as equivalent to words) is summed to measure the extent of disclosure. A research assistant was used to read the Annual Reports to categorise the content of executive directors' remuneration information and count the number of words under the guidance of investigators facilitated by the "word count" function of Microsoft Word software. Investigators randomly selected sampled companies to independently repeat the content analysis in order to achieve accuracy of categorisation and count of the dependent variable measures. Practical matters arose when counting words. These matters and the way they were dealt with in this study are discussed as follows:

- (i) The relevant content was located and formatted in diverse ways in companies' annual reports. It was located in the corporate governance section, the directors' reports and/or the notes to financial statements (including notes on remuneration

disclosure, shares and options, retirement benefit, related parties etc). When the same sentences were repeated in separate sections of an Annual Report, the repeated words were included in the count. It was deemed that repetitive words in an Annual Report strengthened the impact of the information on users.

(ii) The extent of executive directors' remuneration disclosures is affected by the applicable number of executive directors on each company's board, since AASB 1046 (which was forthcoming in 2003 and 2004) required prescribed items of information to be disclosed for each executive director. To be comparable across companies, the dependent variable was based on the extent of disclosure per executive director. Therefore, the measure of the dependent variable for each company became the total number of relevant words disclosure at each of the aggregate level (DITOTAL) and sub-total levels (DISHARES and DITERMIN), respectively, divided by the number of executive directors.

For the independent variables, surrogate measures of legitimacy theory (MEDIA, PROPREMUN and SIZE) and corporate governance quality (BOARDINDEP and REMUNCOM) are given in Table 2.

First, the variable media attention (MEDIA) was obtained from a trawl of articles across all print media sources available in the *Factiva* database. The *Factiva* database comprises of newspapers, newswires and business magazines with the largest circulation in Australia (e.g., *Australian Financial Review*, *BRW*, *AAP newswire*, *The Australian*, *The Advertiser*, *The Courier Mail*, *The Daily Telegraph*, *The Herald Sun*, *The Melbourne Age*, *The Mercury*, *The Sydney Morning Herald* and *The West Australian*). The extent of print media attention is approximated by the number of times that company's name appears in articles relating to executive and director remuneration during a relevant year. Key words used in the search of *Factiva*, based on the theme of the study, were "executive remuneration and disclosure", "executive package and disclosure" and "annual reports and executive remuneration". The number of times that a company is mentioned in these print media sources represents the degree that it attracted public attention. For example, BHP was mentioned 12 and 33 times in 2003 and 2004 respectively. Therefore, the score for media attention is 12 and 33 in 2003 and 2004 respectively. If a company's name didn't show on the print media, score 0 is given. This measurement approach is company-specific, unlike

Brown and Deegan (1998) who only used a period-specific measure of media attention by counting the total number of articles (about corporate environmental disclosure) in print media for each year.

Second, PROPREMUN (the existence of a remuneration resolution in the Notice of AGM) was also found in the *Factiva* database. In this study, a proposed resolution in the Notice of AGM about executive directors' remuneration (shares, options, fees and retire payments) for a particular company is scored as 1. Otherwise, it is scored 0.

Third, SIZE is measured as total assets, after transforming this amount by log 10 in order to obtain normality of distribution of this data. Cullen and Christopher (2002), for example, use log 10 of total assets as a measure for company size in their study of of corporate governance.

Fourth, BOARDINDEP is measured as the proportion of executive directors on the board. Table 3 shows this proportion on boards of companies in the sample in 2003 and 2004.

Table 3 Frequencies of Executive Directors to Total Directors

Percentage	Frequency 2003	Frequency 2004
0-10	8	12
10-20	64	65
20-30	56	43
30-40	22	32
40-50	19	19
50-60	9	10
60-70	8	4
70-80	1	5
80-90	1	1
90-100	3	
Total	191	191

Fifth, REMUNCOM (the existence of a remuneration committee of the board) was found in the companies' Annual Reports. In this study, the existence of such a committee for a particular company is scored as 1. Otherwise, it is scored 0.

6. Analysis and Results

6.1 Descriptive Statistics

Descriptive statistics for those variables based on interval or nominal data are given in Table 4. In relation to disclosures, Table 4 shows that the sample consists of firms with an average of 404 words of executive directors' equity-based and termination benefits disclosure (DITOTAL). The average amount of the disclosure of share rights and options (DISHARES) is 384 words, ranging from 0 to 5509 words. DITERMIN has the lower extent of disclosure with a mean of 14 words. Only 43 companies in 2003 and 24 companies in 2004 disclose information regarding executive directors' termination benefits in their annual reports.

In relation to the independent variables, big companies were the dominant ones named in the print media (MEDIA) in association with executives' and directors' remuneration. For example, the name of Rio Tinto was mentioned 49 times, Coles-Myer (40), AMP (39), BHP (30), Commonwealth Bank (22) and Westfield Holding (20). Interestingly, compared to the limited number of companies referred to by the media, there were many companies in the sample that raised the issue of executive directors' compensation at their AGM (112 companies in 2003 and 98 in 2004).

In terms of BOARDINDEP, Table 3 presented the frequency distribution of board composition. In Table 4, it shows that 27 per cent of board members, on average, are executive directors. There were three companies in 2003 (none in 2004) whose board consisted only of executive directors.

Table 4 Descriptive Statistics for Variables

	Number of Company	Range	Minimum	Maximum	Mean	Standard Deviation
DITOTAL	382	5509.00	0.00	5509.00	404.30	563.85

DISHARES	373	5509.00	0.00	5509.00	384.42	546.73
DITERMIN	373	974.00	0.00	974.00	14.39	60.86
MEDIA	382	49	0	49	1.37	4.85
BOARDINDEP	382	100.00	0.00	100.00	27.06	16.86

6.2 Univariate Analysis

To identify the change in extent of disclosures of share rights, options and termination benefits between 2003 and 2004 and whether this change differs between industries, results of independent-samples t-tests are presented in Table 5. The industries of energy, information technology, telecommunication services and utilities have been grouped under miscellaneous because the sample in these industries is too small for univariate analysis.

Panel A of Table 5 reveals that DITOTAL has increased for sampled companies in aggregate, with an average number of words increasing from 229 to 578 words. Every industry has had a significant increase in disclosure from 2003 to 2004. Panel B of Table 5 shows a similar pattern of significant increase in disclosure regarding executive share rights and options (DISHARES). The highest levels of this disclosure are evident in the financials, materials and consumer staples industries.

Panel C of Table 5 reveals a different picture for disclosure of executive directors' termination benefits (DITERMIN). The mean differences between 2003 and 2004 are not significant (at 0.05 level) for the total sampled companies or for individual industries.

Table 5 Disclosure of Executive Share Rights, Options and Termination Benefits: Comparison of Means by Years and Industries

Panel A					
Industry	Number	DITOTAL		Difference of Means	
		2003	2004	T-value	Significance
Consumer Discretionary	33	120.8005	355.0495	-3.906	0.000
Consumer Staples	24	237.1825	524.3768	-3.907	0.000
Financials	34	329.1740	928.2294	-2.604	0.013
Health Care	11	149.8788	434.2091	-3.165	0.005

Industrials	37	159.0968	378.2973	-2.896	0.006
Materials	35	291.9844	715.2833	-3.879	0.000
Miscellaneous	17				
Total	191	229.6422	578.9644	-6.3609	0.000
Panel B					
Industry		DISHARES		Difference of Means	
		2003	2004	T-value	Significance
Consumer Discretionary	33	113.4419	350.9586	-4.084	0.000
Consumer Staples	24	227.4812	533.3201	-3.171	0.003
Financials	34	309.1717	922.1422	-2.604	0.013
Health Care	11	146.7879	434.2091	-3.183	0.005
Industrials	37	152.9482	370.1351	-2.920	0.005
Materials	35	271.5558	639.3333	-3.498	0.001
Miscellaneous	17				
Total	191	216.7288	556.6777	-6.254	0.000
Panel C					
Industry		DITERMIN		Difference of Means	
		2003	2004	T-value	Significance
Consumer Discretionary	33	7.3586	4.0909	0.563	0.575
Consumer Staples	24	9.7014	0.0000	2.495	0.020
Financials	34	27.3712	44.3516	-0.529	0.599
Health Care	11	3.0909	0.0000	1.000	0.341
Industrials	37	6.1486	8.1622	-0.247	0.785
Materials	35	20.4286	22.6328	-0.212	0.832
Miscellaneous	17				
Total	191	13.4969	15.3125	-0.288	0.774

In discussion of the findings in Table 5, the jump in the extent of disclosure of executive directors' share-based remuneration indicates that discretionary disclosure decisions by company management (i.e., executive directors and their management team) are strongly influenced by an *anticipated* change in the regulatory requirements. Thus, companies have responded in 2004 to the fact that AASB 1046 '*Director and Executive Disclosures by Disclosing Entities*' (issued in January, 2004) would become operative for 2005 annual reports. Additionally, CLERP9 amendments to the Corporations Act would become effective for 2005 annual reports. Legitimacy theory is likely to explain why some leading companies in their industry (especially in financials and materials industries) chose in 2004 to early-adopt AASB 1046. At the same time, other companies in the industry significantly increased their voluntary disclosure of items associated with the forthcoming AASB 1046 and forthcoming CLERP9 amendments in order to manage their reputation with shareholders and the public. They would have been concerned about external pressures to be proactively

transparent when it comes to information about the executive directors themselves. However, in contrast to disclosures of share-based remuneration, the disclosures about executive directors' termination benefits did not increase in 2004. AASB 1046 and CLERP 9 had not prescribed new disclosure requirements in this area. Consequently, external pressures on management to provide discretionary disclosures may not have been felt in relation to termination benefits. Whether legitimacy concerns were the driving influence behind the jump in disclosures of share-based remuneration, but not termination benefits, in 2004, is to be tested under multivariate analysis in the next section.

An alternative explanation for the jump in disclosure of share-based remuneration in 2004 is the improvements made in corporate governance practices. The ASX Corporate Governance Council's guidelines (specifically Recommendation 9) were issued in March 2003, but may have been phased in by listed companies over 2003 and 2004 since they were not prescriptions but guidelines. Thus, companies that adopted other ASX recommendations concerned with establishing good corporate governance structures, may also have adopted recommendation 9 on disclosure of executive and director remuneration details in their annual reports. Whether corporate governance changes were attributable to the jump in disclosures in 2004 is also to be tested in the multivariate analysis section.

6.3 Multivariate Analysis

Linear multiple regression is used as the basis of analysis for testing the five hypotheses. The effects of legitimacy theory and corporate governance determinants on the disclosure of share rights, options and termination benefits are modeled in equation A:

$$DI = \alpha + \beta_1 MEDIA_i + \beta_2 PROPREMUN_i + \beta_3 SIZE_i + \beta_4 BOARDINDEP_i + \beta_5 REMUNCOM_i + \varepsilon \quad (\text{equation A})$$

where variable definitions are given in Table 2.

The influence of company size on disclosure can be dominant in the results from equation A. To control for company size, those companies with total assets greater

than AUD10 000 million can be removed from sample, and the regression analysis can be run again based on equation B.

$$DI = \alpha + \beta_1 \text{ MEDIA}_i + \beta_2 \text{ PROPREMUN}_i + \beta_3 \text{ BOARDINDEP}_i + \beta_4 \text{ REMUNCOM}_i + \varepsilon$$

(equation B)

The results for these two regression equations for 2003 and 2004, respectively (i.e., four models), are given in Table 6 (where DITOTAL is the dependent variable) and Table 7 (where DISHARES is the dependent variable). Table 8 (where DITERMIN is the dependent variable) has only presented two models because there are a high number of cases of missing data for the dependent variable, disclosure of executives' termination benefits, which results in a poor model fit. In all the regression models presented, multicollinearity is tested by both the tolerance and the variance inflation factor (VIF) tests. The results reveal that multicollinearity is well within the satisfactory range. Further, in each of tables 6 to 8, the results in models 1 and 2 are based on the total sample of 191 companies. When large companies are removed from the data (i.e., size of company is controlled for), results in models 3 and 4 are based on a sample of 173 (for 2003) and 165 (for 2004).

Table 6 Multiple Regression Results for Disclosure of Executive Share rights, Options and Termination Benefits (DITOTAL)

Equation A (Including Total Sample)						
	2003 (Model 1)			2004 (Model 2)		
Variables	Beta	t	Sig.	Beta	t	Sig.
(Constant)		-1.141	0.255		-1.330	0.185
MEDIA	-0.016	-0.221	0.825	0.045	0.701	0.484
PROPREMUN	0.139	2.170	0.031	0.105	1.751	0.082
SIZE	0.368	4.926	0.000	0.406	5.942	0.000
BOARDINDEP	-0.220	-3.151	0.002	-0.268	-4.250	0.000
REMUNCOM	0.007	0.110	0.913	0.020	0.340	0.734
Model Fit	R Square = 0.261, Adjusted R Square = 0.241, Durbin-Watson = 1.860, F = 13.081, Sig. = 0.000			R Square = 0.361, Adjusted R Square = 0.344, Durbin-Watson = 1.663, F = 20.902, Sig. = 0.000		
Equation B (Sample Excluding Big Companies)						
	2003 (Model 3)			2004 (Model 4)		
Variables	Beta	t	Sig.	Beta	t	Sig.
(Constant)		5.314	0.000		6.300	0.000
MEDIA	-0.042	-0.599	0.550	0.203	3.027	0.003
PROPREMUN	0.124	1.751	0.082	0.126	1.885	0.061
BOARDINDEP	-0.369	-4.918	0.000	-0.433	-6.373	0.000
REMUNCOM	-0.008	-0.108	0.914	-0.021	-0.314	0.754

Model Fit	R Square = 0.158, Adjusted R Square = 0.138, Durbin-Watson = 2.280, F = 7.959, Sig. = 0.000	R Square = 0.265, Adjusted R Square = 0.248, Durbin-Watson = 2.009, F = 15.091, Sig. = 0.000
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Table 7 Multiple Regression Results for Disclosure of Executive Share rights and Options (DISHARE)

Equation A (Including Total Sample)						
	2003 (Model 1)			2004 (Model 2)		
Variables	Beta	t	Sig.	Beta	t	Sig.
(Constant)		-1.044	0.298		-0.936	0.351
MEDIA	-0.032	-0.440	0.660	0.040	0.591	0.555
PROPREMUN	0.136	2.087	0.038	0.101	1.631	0.105
SIZE	0.359	4.742	0.000	0.384	5.444	0.000
BOARDINDEP	-0.221	-3.121	0.002	-0.277	-4.281	0.000
REMUNCOM	0.009	0.131	0.896	0.025	0.404	0.687
Model Fit	R Square = 0.248, Adjusted R Square = 0.228, Durbin-Watson = 1.894, F = 12.102, Sig. = 0.000			R Square = 0.345, Adjusted R Square = 0.327, Durbin-Watson = 1.553, F = 18.745, Sig. = 0.000		
Equation B (Sample Excluding Big Companies)						
	2003 (Model 3)			2004 (Model 4)		
Variables	Beta	t	Sig.	Beta	t	Sig.
(Constant)		5.287	0.000		6.371	0.000
MEDIA	-0.037	-0.514	0.608	0.225	3.269	0.001
PROPREMUN	0.128	1.793	0.075	0.105	1.531	0.128
BOARDINDEP	-0.369	-4.881	0.000	-0.419	-6.042	0.000
REMUNCOM	-0.016	-0.218	0.828	-0.023	-0.331	0.741
Model Fit	R Square = 0.158, Adjusted R Square = 0.138, Durbin-Watson = 2.211, F = 7.875, Sig. = 0.000			R Square = 0.266, Adjusted R Square = 0.248, Durbin-Watson = 2.198, F = 14.523, Sig. = 0.000		

Table 8 Multiple Regression Results for Disclosure of Executive Termination Benefits (DITERMIN)

Equation A (Including Total Sample)						
	2003 (Model 1)			2004 (Model 2)		
Variables	Beta	t	Sig.	Beta	t	Sig.
(Constant)		-0.312	0.755		-1.779	0.077
MEDIA	0.121	1.503	0.135	0.064	0.829	0.408
PROPREMUN	0.028	0.397	0.692	-0.125	-1.734	0.085
SIZE	0.181	2.181	0.030	0.302	3.700	0.000
BOARDINDEP	-0.119	-1.538	0.126	-0.055	-0.740	0.460
REMUNCOM	-0.017	-0.223	0.824	-0.012	-0.162	0.872
Model Fit	R Square = 0.099, Adjusted R Square = 0.074, Durbin-Watson = 1.957, F = 4.021, Sig. = 0.002			R Square = 0.124, Adjusted R Square = 0.099, Durbin-Watson = 1.680, F = 5.043, Sig. = 0.000		

The results in Tables 6 to 8 are now discussed in terms of tests of each of the five hypotheses established in this paper.

First, H1 states that the extent of executive remuneration disclosure will be greater due to higher media attention, where the media attention specifically exposes the company concerning its remuneration to executives and directors during the year. The results in the three Tables do not support H1. MEDIA has no significant effect on DITOTAL, DISHARES or DITERMIN in 2003. In 2004, there is a significant relationship between MEDIA and both DITOTAL and DISHARES (see Model 4 in Tables 6 and 7), although explanatory power is low (i.e., Beta = -.016 and -.032, respectively). More importantly, these results are significant inverse relationships, which means they are in the opposite direction to the positive relationship hypothesised in H1. Legitimacy theory would reason that management provides more corporate disclosure as a legitimacy management tactic in response to higher media attention (Brown & Deegan, 1998). However, the evidence we provide is that management (i.e., executive directors) appears to adopt a different legitimacy tactic when it comes to disclosures about their own personal remuneration. Perhaps they view the media attention as a matter affecting their own personal legitimacy with shareholders, more than the general legitimacy of their company. If so, they may provide shareholders with greater disclosures about their remuneration by way of personal letters or verbal statements at AGMs, rather than disclosures in notes to accounting in the Annual Report.

Second, H2 states that the existence of a proposal to increase executives' remuneration at the next AGM (PROPREMUN) and, therefore, place this issue directly under the attention and decision-making influence of the shareholders, will positively impact on disclosure in the Annual Report (where the Annual Report will be available at the AGM). The results in Tables 6 to 8 reveal that PROPREMUN is significantly positively related to DITOTAL, DISHARES and DITERMIN in both 2003 and 2004 (at sig.< .10 level). Two exceptions are that DISHARES for 2004 (model 4, Table 7) and DITERMIN for 2003 (model 1, Table 8) are not significant. But the picture is that H2 is accepted. Since the shareholders (and the press) could potentially view an AGM proposed resolution to increase executive directors' compensation as representing excessive perquisites to management, and potentially compromising their legitimacy and even "destroying (their) effectiveness" (Boyd, 1994), the legitimacy tactic of increased disclosure in the Annual Report is strongly evident in this study.

Third, H3 states that the larger the size of a company (SIZE), the greater will be the extent of corporate disclosure of executives' remuneration. Larger companies are under greater public scrutiny and are more likely to face political costs. Therefore, they have an incentive to give greater attention to legitimisation management through higher disclosure about the publicly-sensitive matter of executive remuneration. The results show that larger size companies are associated with higher levels of disclosure in all six models in which it is included. H3 is accepted. This result is consistent with the finding of Eng and Mak (2003) and Cullen and Christopher (2002) who concluded that company size is a major determinant of governance-related disclosures. The weakness of SIZE as an independent variable is that it is a poor surrogate measure of exposure to external scrutiny; it is a surrogate for other extraneous variables such as disclosure expertise and ability to absorb disclosure costs.

Turning to corporate governance determinants, H4 states that the lower the proportion of executive directors on the board (BOARDINDEP) the higher will be executive remuneration disclosure. Outside or independent directors, because of their need to protect their own high reputation with shareholders, will be concerned to ensure that executives' and directors' remuneration information is made transparent to the shareholders. The results for all models relating to DITOTAL (Table 6) and DISHARES (Table 7) indicate that companies with a higher proportion of executive directors in board have a lower level of reported executive disclosure (all have sig > .02). This study's evidence infers that executive directors on the board are reluctant to reported their cash-based and equity-based compensation in the Annual Reports. Therefore, H4 is accepted. Previous studies have found confused results regarding the impact of proportion of non-executive directors on corporate governance related disclosure. Chen and Jaggi's (2000) found that increased presence of outside directors was related to higher levels of voluntary disclosure on corporate governance in Hong Kong. In contrast, the study of Eng and Mak (2003) concluded that voluntary disclosure is negatively associated with the proportion of non-executive directors on the board in Singapore.

A second corporate governance determinant that would affect decisions by the board about disclosures of executive and director remuneration is the establishment of a

Remuneration Committee of the board (REMUNCOM). H5 states that REMUNCOM is positively related to the extent of executive directors' disclosure. The results reveal that REMUNCOM is not significant in any of the models in Tables 6, 7 and 8. Therefore, H5 is rejected. This finding suggests that a Remuneration Committee is *not* likely to push the board to seek more, rather than less, executive remuneration disclosure in the Annual Report.

7 Conclusion

This study addresses the topical issue of top executives' remuneration packages. There is widespread interest from corporate shareholders and wider stakeholders in compensation contracts of the top executives, largely because of the established belief that the structuring of such contracts can mitigate the conflict of interest between managers and shareholders. This has generated a body of literature on the relationship between the structuring of rewards to top executives and organizational performance. However, shareholders and other stakeholders rely on disclosures about top executives' remuneration contracts and annual changes in remuneration in order to consider the alignment of those contracts with their stakeholder interests. Despite the importance of disclosures to stakeholders, there has been a lack of literature on the variability in the extent of executives' remuneration disclosure and on the determinant of such discretionary disclosure.

To provide evidence about the extent of corporate disclosure of executives' share rights, options and termination benefits in companies Annual Reports, and the determinants of this disclosure, data was drawn from a sample of Australian listed companies in the pre-regulatory reform year of 2003 and the highly anticipated regulatory reform year of 2004. Determinants of this disclosure were drawn from two theoretical perspectives. From an institutional legitimacy perspective, proxies used were media attention (in terms of companies being named in the context of executives' remuneration in the print media), shareholder activism (in discussing and voting on proposed changes to executive remuneration at AGM) and company size (as a reflection of political exposure); From a corporate governance perspective, the proxies used were board composition (in terms of proportion of executive to outside directors on the board) and the existence of a remuneration committee of the board.

The results reveal that there was a significant increase in every industry in the extent of disclosure of executive directors' remuneration overall and in share-based remuneration from 2003 to 2004. While there was no regulatory change in disclosure requirements between 2003 and 2004, there was clarity in 2004 on the major changes that would become effective in 2005 (i.e., AASB1046 and CLERP9 revisions). Hence, the evidence indicates that discretionary disclosure decisions by company management (i.e., executive directors and their management team) are strongly influenced by an *anticipated* change in the regulatory requirements, and the opportunity to take early adoption of an accounting standard (AASB1046).

In relation to determinants of discretionary disclosure, the results are significant for some hypotheses but not others. There is no support for the influence of media attention on the extent of executive remuneration disclosure, other than weak evidence of media attention leading to less disclosure which contradicts legitimacy theory. In contrast, expected shareholder activism (due to the existence of a proposal to increase executives' remuneration at the next AGM) and the size of the company are found to have a significant positive impact on disclosure in the Annual Report in both 2003 and 2004. Both results are indications of discretionary disclosure being a legitimacy management tactic. In relation to corporate governance, the composition of the board is found to have a significant impact on disclosure, with a higher proportion of executive directors in board resulting in a lower level of executive remuneration disclosure, suggesting that executive directors will resist the reporting of their own compensation in the Annual Report. Finally, the existence of a remuneration committee is found to have no effect on disclosures.

In summary, listed companies in Australia have responded to public pressure and shareholder concern following the corporate scandals/collapses and corporate governance debates after 2002, by using discretionary disclosure of executives' remuneration as an approach to shaping public perceptions. But evidence of the extent of disclosure in 2003 suggests that this legitimacy tactic was quite limited in its use in that year. It was heavily stimulated in 2004 by the eminent introduction one year later of severe disclosure regulations. In addition, the corporate governance factor of more

executives on the board has reduced voluntary disclosure about their own compensation – i.e., has limited the use of the legitimacy management tactic.

This study has limitations in its empirical modeling and variable measurement. First, the empirical schema does not include additional independent variables linked to corporate governance mechanisms such as duality of the CEO, demographic background of the executive directors and ownership structure. These are all extraneous variables that could impact on the extent of executive remuneration disclosure. Also the empirical modeling is for two comparative years, during which a major event may have occurred for a company or industry which has a confounding effect on the relevant disclosure (such as dismissal of a company's CEO or the industry effect of a major international competitor entering the industry who practices greater voluntary disclosure). A further modeling limitation is that the extent of disclosure has been measured by total word counts for different categories of disclosure, without separating those parts of disclosures that are reported under minimum mandatory disclosure requirements from those parts that are discretionary. This means that the extent of disclosure under mandatory requirements (which was not substantial in 2003 and 2004) is assumed to be constant for all sampled companies.

Second, data collected to measure some variables does not comprehensively cover some of the constructs being measured. Specifically, media attention only measures the number of citations of company names within the text of relevant newspaper articles or columns. It does not consider font size, accompanying pictures, length of article, page in the newspaper or weight of importance of the newspaper. Also time differences throughout a year between the publishing of print media articles and the release of a company's Annual Reports were not adjusted for in the measure of media attention. In respect of another variable, the existence of a remuneration committee has not measured the frequency of meetings or the composition of the committee.

Given the above limitations, this study makes a contribution to the corporate disclosure literature by providing new evidence about a component of corporate disclosure that is personally sensitive to the top executives and directors, viz., their own remuneration. It finds that management decisions about the extent of supply of

discretionary disclosure are influenced by anticipation of forthcoming mandatory disclosure requirements, legitimacy management tactics and the presence of certain corporate governance mechanisms.

Future research could take the following directions. First, this study could be extended to 2005 when AASB 1046 became effective for all reporting entities, in order to test Dye's (1986) proposition that when mandatory disclosure of proprietary information increases, voluntary disclosure will also increase. Second, the study could examine determinants of executive remuneration disclosure from other theoretical perspectives such as signaling theory and expectancy theory where proprietary and political costs of disclosure could be considered from both a corporate viewpoint and an individual executive director's viewpoint. Third, the relationship between the extent of executive remuneration disclosure, the amount of remuneration and both corporate performance and individual executive director performance could be investigated beyond previous studies (e.g., Mehran, 1995) that have found company performance to be related to equity-based compensation.

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