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Voluntary Disclosure and Political Sensitivity: The Case of Executive Remuneration

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ABSTRACT

This study investigates the relation between firm political sensitivity and the quality and quantity of voluntary disclosures, with special reference to the case of executive remuneration disclosures. I study the relation between firm political sensitivity and the quality and quantity of annual bonus plan disclosures, applying two competing (but not mutually exclusive) theories: political cost theory and managerial power theory. Political sensitivity is proxied using the magnitude of the annual bonus rather than firm size, which while popular in existing literature, is not a perfect proxy for political sensitivity (Ball and Foster, 1982, Meek et al, 1995; Cormier et al, 2005). Results reveal a significant *positive* relation between disclosure quantity and political sensitivity measures, and a significant *negative* relation between disclosure quality and political sensitivity proxies. This indicates that managers who are more susceptible to political sanctions related to their remuneration tend to disclose higher volumes of lower quality information. Consistent with earlier studies, the results confirm that firm size is related to voluntary disclosure, and the results also reveal that the use of remuneration consultants have a significant *positive* effect on disclosure quantity but no impact on disclosure quality.

KEYWORDS: corporate governance, executive remuneration, voluntary disclosure, disclosure quality, remuneration consultants.

JEL Classifications: M52, J33, D82

1. Introduction

This study investigates the relation between firm political sensitivity and the quality and quantity of voluntary disclosures, with special reference to the case of executive remuneration disclosures. The evolution of executive remuneration disclosure requirements in the UK over the past 15 years, from being minimal and mandatory, to comprehensive but voluntary, to the current regime of comprehensive and mandatory, illustrates the increasing political costs of disclosure faced by UK firms. While no salary cap is currently enforced, political sanctions are implemented via extensive disclosure requirements in the hope that greater transparency regarding the executive pay process enables shareholders to discipline managers whose remuneration is not commensurate with firm performance. The UK Directors' Remuneration Report Regulations (DRRR) (2002), which formed part of the regulatory response to criticism regarding spiralling executive remuneration, require firms to disclose extensive details of long-term remuneration plans. In contrast, the regulations remain silent on the level of detail required for components of short-term remuneration such as annual bonus plans. The discretionary element in the level of disclosures relating to annual bonus plans provides an opportunity to study voluntary disclosure behaviour related to executive remuneration. Specifically, I study the relation between firm political sensitivity and the quality and quantity of annual bonus plan disclosures, applying two competing (but not mutually exclusive) theories: political cost theory and managerial power theory.

Earlier studies have investigated how political sensitivity affects voluntary disclosure of financial information. Jones (1991), Cahan (1992), Murphy (1996) and

Baker (1999) find that firms react to increasing political costs by disclosing financial information designed to reduce their political sensitivity. In terms of the how disclosure quantity and quality varies with political sensitivity, Meek et al. (1995) find that voluntary disclosure in annual reports is positively related to firm size, which serves as their proxy for political sensitivity. Similarly, Raffournier (1999) and Oliveira et al. (2005) find that the incidence of increased voluntary financial disclosures and voluntary disclosure of intangibles, respectively, are positively associated with firm size. Meanwhile, Clarkson, Van Bueren and Walker (2006) find that disclosure quality related to executive remuneration is positively related to public scrutiny of the firm, which the authors measure using the number of articles containing the phrase “executive remuneration” appearing in the Australian Financial Review between 1999 and 2004.

While existing studies document a link between aspects of firms’ disclosure strategy and political sensitivity broadly defined, existing studies overlook three important issues. First, extant research does not simultaneously compare the impact of political sensitivity on disclosure quality and disclosure quantity using the same data set. Second, existing studies have yet to study disclosures relating to UK executive remuneration. Third, firm size is popularly used proxy for the level of political sensitivity a firm faces. While plausible, size is also considered to be a noisy proxy as it firm size captures a multitude of other factors (Ball and Foster, 1982, Meek et al., 1995; Cormier et al., 2005). To shed new light on these issues I construct distinct measures of disclosure quality and quantity, and examine the impact of political sensitivity on each dimension separately. In particular, I analyse voluntary disclosures relating to annual bonus arrangements for executive directors, and how the quantity and quality of such

disclosures vary in response to concerns regarding excessive executive remuneration. I also use the magnitude of executive remuneration to proxy for the level of political sensitivity a firm faces as a way to overcome the imperfect proxy often used in existing literature, firm size.

My analysis is motivated by two alternative (but not necessarily mutually exclusive) theoretical perspectives on the link between political sensitivity and disclosure. On the one hand, the relation between political sensitivity and corporate disclosure can be explained by the political cost theory (Watts and Zimmerman, 1978), which predicts that managers seek to minimise political costs by providing more extensive, higher quality disclosures so as to pre-empt political sanctions (Zimmerman, 1983; Meek, et al. ,1995; Raffournier, 1999; Oliviera et al., 2005; Baker, 1999). On the other hand, managerial power theory argues that managerial opportunism overrides arms-length transactions and bargaining, resulting in managers trying to camouflage their rent-extraction activities (Bebchuk et al., 2002). According to this theory, greater sensitivity over remuneration levels leads to lower quality disclosures designed to hide managerial opportunism in the form of excessive compensation.

My analysis is based on data for 400 large UK firms. I measure disclosure quality by creating an index which scores disclosures according to the transparency and detail with which information on executives' short-term bonus arrangements are reported. The index is created by benchmarking information on annual bonus plans produced in the remuneration report with disclosures for long-term plans mandated by the Directors' Remuneration Report Regulations (2002), and with best practice disclosure recommendations established by the Association of British Insurers (ABI) and the

National Association of Pension Funds (NAPF). Disclosure quantity, on the other hand, is measured as the number of pages in the remuneration report as a fraction of the total number of pages in the annual report. To capture political sensitivity specific to executive remuneration (annual bonus) disclosures, I use data on annual bonuses paid to executive directors, measured using both the raw value and as abnormal payments conditional on firm performance. Remuneration information are obtained from Manifest Ltd in the first instance, and in the case of incomplete information, supplemented with data manually extracted from published annual reports.

Results reveal a significant *positive* relation between disclosure quantity and political sensitivity measures, and a significant *negative* relation between disclosure quality and political sensitivity proxies. This indicates that managers who are more susceptible to political sanctions related to their remuneration tend to disclose higher volumes of lower quality information. Overall, the results are consistent with the managerial power hypothesis.

In addition to the main findings, I also observe that when firms employ a compensation consultant, there is a significant *positive* effect on disclosure quantity but no impact on disclosure quality. I also observe a significant positive firm size effect consistent with prior research (see, for instance, Meek et al., 1995; Oliviera, et al., 2005; Raffournier, 1999).

The remainder of the paper is structured as follows. The next section discusses the motivation for the paper, reviews prior studies and formulates my hypothesis. Section 3 then discusses the methodology used, followed by a discussion of the sample and data

collection process in Section 4. I present the results of the study in Section 5, and Section 6 concludes.

2. Motivation, Literature Review and Hypotheses

Institutional Setting and Research Motivation

The governance of executive remuneration-related disclosures in the UK traditionally fell under the jurisdiction of the Companies Act. In the early 1990's, the accounting profession and the London Stock Exchange commissioned a series of reports in response to the financial scandals that rocked the UK corporate sector at that time, notably that of Polly Peck, BCCI and Maxwell. The first of those reports, the Cadbury Report (1992) suggested additional executive remuneration disclosure requirements beyond those required by the Companies Act but it was the Greenbury Report (1995) that focused specifically on issues relating to executive remuneration. The recommendations regarding executive remuneration disclosure made by the Cadbury Report (1992) and the Greenbury Report (1995) formed part of the Combined Code (2001). However, there was no legal onus on firms to comply with the Combine Code's recommendations. Instead, should a firm not wish to comply with the recommendations, they could opt out by providing shareholders with a statement explaining their reasons for non-compliance. This situation changed in 2002 when a review of boardroom pay practices resulted in amendments to the Companies Act. For reporting periods ending on or after 31 December 2002, firms have been required to present a separate remuneration report with comprehensive executive remuneration information as part of the annual report to shareholders.

Prior to the 2002 boardroom pay-related revisions, Company Law required firms to disclose aggregate amounts of directors' remuneration, pensions and severance pay as part of the notes to the accounts. The Cadbury Report (1992) recommended that disclosures of directors' remuneration, the chairman and the highest paid UK-director should be separated into salary and performance-related pay elements, and disclosed as part of a corporate governance report that. Cadbury (1992) also suggested the criteria of performance-related aspects of pay should be disclosed, and that information regarding stock options, stock appreciation rights and pension contributions should also be discussed.

The next report to be published, the Greenbury Report, focused on improving the link between pay and performance. The Greenbury Report (1995) expanded suggestions of the Cadbury Report (1992), recommending that firms report full details of all elements of executive remuneration packages, broken down by salary, benefits in kind, annual bonuses and long-term incentives (including share options) for individual directors. Greenbury (1995) also recommends that firms disclose their remuneration policy, pension entitlements, and details on option grants, service contracts and directors' shareholdings in a report addressed to shareholders prepared by the Remuneration Committee.¹ With greater disclosure of how and what executives are paid, shareholders are better equipped to evaluate how managerial pay relates to firm performance.

The Combined Code (1998, 2001) adopted the recommendations of the Cadbury (1992) and Greenbury (1995) Reports. However, these recommendations were voluntary and did not carry the force of law. Firms listed on the London Stock Exchange had the

option not to comply with the recommendations provided they explain any instances of non-compliance.

A boardroom pay review exercise carried out by the Department of Trade and Industry in 2001 changed the executive remuneration reporting requirements. A comprehensive set of remuneration-related disclosures called the Directors' Remuneration Report Regulations (DRRR) (2002) was appended to the Companies Act, effectively adding the force of law to detailed remuneration reporting. The DRRR (2002), which became effective for firms reporting on or after 31 December 2002 required firms to prepare a separate stand-alone remuneration report as part of the annual report containing information pertaining to performance targets and benchmarks used in long term incentive plans, details of service contracts and termination pay, and a graph depicting the firm's total shareholder return relative to the performance of a chosen index. In addition to these disclosure requirements, the DRRR (2002) also requires the following details of directors' remuneration to be audited: total compensation, share options and long-term incentive plans, pensions for each director, excess retirement benefits of past directors, compensation paid to past directors and sums paid to third parties in respect of a director's services.

Over the past two decades, executive remuneration disclosure has therefore moved from being mandatory in nature and minimal in detail (Companies Act prior to 2002), to being voluntary in nature and comprehensive in scope (Cadbury, Greenbury and Combined Code recommendations, on top of the minimal Companies Act requirements), to being mandatory in nature, comprehensive in detail and requiring audit (Directors' Remuneration Report Regulations, 2002). This has changed the landscape of

remuneration reporting in the UK substantially. A wealth of previously unavailable remuneration-related information is now required to be disclosed as part of the annual report, and management no longer have the choice to ignore disclosure requirements and provide an explanation of non-compliance.

While the comprehensive nature of disclosure requirements leave little room for managerial choice in reporting long-term remuneration information, managerial discretion is still exists in two key areas. First, the choice of index against which firms' total shareholder return is measured and reported in graphical form. Second, the amount of information provided about short-term remuneration arrangements (e.g. bonus plans). In particular, the Directors' Remuneration Report Regulations requires disclosures of the use of annual bonus plans but leaves disclosure of plan details such as performance measures, reward targets and benchmarks to the discretion of management.

I exploit the discretionary nature of annual bonus plan disclosures to study how firms' political sensitivity affects disclosure strategies. In particular, I test whether political sensitivity regarding remuneration arrangements affects how managers report annual bonus scheme information. In the next section I discuss the theoretical basis of the research question and review the related literature examining the relation between disclosure strategies and political sensitivity.

Theoretical Framework and Literature

The actions, reactions, achievements and misfortunes of firms are part of the socio-economic environment in which they operate. Firms are often criticised if they undertake what is perceived by stakeholders to be unwise decisions relating to issues such as the environment (Deegan and Gordon, 1996), make what stakeholders perceive

to be excessive profit (Watts and Zimmerman, 1978), or pay their managers what stakeholders view as excessive remuneration (Baker, 1999). These issues, when raised by various stakeholder groups, can result in political sanctions against firms including increased tax rates (Watts and Zimmerman, 1978) and demands for greater transparency (Deegan and Gordon, 1996). Managers therefore have an interest in managing politically sensitive issues to minimise political costs. This translates into subsequent action taken by managers, for example by making decisions regarding accounting methods used, or what information is disclosed. Cahan (1992) finds managers of firms under investigation for monopoly-related violations managed earnings during periods of investigation when the firm's earnings were perceived to be more politically sensitive. Jones (1991) also found that managers manipulated earnings downwards during periods of import relief investigations to decrease firm political sensitivity.

Evidence from the remuneration literature also suggests that choices made to manage excessive managerial remuneration are also motivated by political sensitivity. Murphy (1996) finds that managers prefer to report grant-date values of options in their SEC filings only when they are lower than potential option values. He also finds that when stocks are volatile and dividend yields are low, larger discounts are applied to the grant-date values. Baker (1999) finds that firms with higher components of unexplained remuneration (remuneration not related to performance) are more likely to report lower grant-date values of options. Both disclosure strategies observed by Murphy (1996) and Baker (1999) result in lower reported values of remuneration.

Existing evidence also documents that levels of voluntary disclosure are influenced by firms' political visibility and sensitivity. Meek et al. (1995) find that high

levels of voluntary disclosure are significantly related to firm size, which proxies for political sensitivity. Raffournier (1999) reports a similarly strong positive relation between voluntary financial disclosures and firm size for a sample of Swiss firms. Oliviera et al. (2005) find that the quantity of intangible-related disclosures increases with firm size for a sample of firms listed on the Lisbon Euronext market. However, a drawback of these studies is the use of size to proxy for political sensitivity. Ball and Foster (1982) argue that while firm size affects political sensitivity (as proposed by Watts and Zimmerman, 1978), it may also capture other factors. Ball and Foster (1982) demonstrate that in relation to political sensitivity, size has also been used to proxy for competitive advantage (Belkaoui and Kahl, 1978) and information product cost (Firth, 1979). I further discuss this issue and how it is addressed in this paper in the next section.

The motivation of this study follows from the above observations. It examines how the level of voluntary disclosure of remuneration information is affected by how sensitive firms are to what the public observes its managerial remuneration to be. I seek to explain this relation using two competing theories: political cost theory and managerial power theory.

Political cost theory builds from the economic theories of the political process, which is viewed as a competition for wealth transfers. Political processes are also used as a way to remedy what is perceived by stakeholders to be market failures. According to political cost theory, executives are hypothesized to manage the visibility of politically sensitive information so as to minimise potential wealth transfers from the firm as a result of sanctions. The political cost hypothesis predicts that when managers are presented with a choice in reporting information about the firm, managers prefer choices

that decrease political sensitivity. Politically sensitive firms are therefore expected to provide disclosures that are high in quality and quantity to circumvent further political sanctions.

The managerial power theory of executive remuneration contends that the arms' length transaction assumption inherent in managerial contracting models does not hold because it is overridden by managerial power (Bebchuk et al., 2002). The close social network among boards of director is argued to increase managerial bargaining power. The theory introduced the terms 'outrage', referring to stakeholder reaction towards excessive pay, and 'camouflage', referring to techniques managers use to hide excessive pay from stakeholders. Bebchuk et al. (2002) argue that managers take actions to minimise 'outrage' through 'camouflage' techniques such as hiding remuneration elements in complicated remuneration schemes or making opaque disclosures.

Of the two theories discussed above, political cost theory has been more prolifically tested in empirical studies, although not pertaining to executive remuneration. To date I am not aware of any study that uses managerial power theory to explain firm disclosure policy or managerial choice behaviour. Furthermore, Bebchuk et al.'s (2002) managerial power theory relates to remuneration contracting specifically, whereas political cost theory explores agency issues in various settings. As this study examines remuneration-related voluntary disclosures, either theory could potentially explain disclosure choices. The descriptive validity of the political cost and managerial power theories in relation to executive remuneration is an empirical issue, which this analysis hopes to shed light on.

3. Research Methodology

In this section I present the regression models used in the empirical analysis and discuss how I measure political sensitivity, disclosure quality and disclosure quantity. I then discuss the control variables used in the model.

Regression Models

This study employs two ordinary least squares (OLS) regression models. The first model tests the association between disclosure *quality* and political sensitivity. The second model tests the relation between disclosure *quantity* and political sensitivity. The disclosure quality model is specified as below:

$$DiscQual_{it} = \alpha + \beta_1 remmeasure_{it} + \beta_2 Controls_{it} + \varepsilon_{it} \quad (1)$$

where *DiscQual* is a proxy for disclosure quality, measured using a normalised disclosure quality index score; *remmeasure* is a proxy for political costs measured using average bonus pay across executive board members; *Controls* is a vector of *k* additional determinants of disclosure quality; ε is the error term and *i* and *t* are firm and time subscripts respectively.

The disclosure quantity model is specified as below:

$$DiscQuant_{it} = \alpha + \beta_1 remmeasure_{it} + \beta_2 Controls_{it} + \varepsilon_{it} \quad (2)$$

where *DiscQuant* is a proxy for disclosure quantity, measured using the percentage of remuneration report pages as part of the annual report; *remmeasure* is a proxy for political costs as defined in equation (1); *Controls* is a vector of *j* determinants of

disclosure quantity; ε is the error term, and i and t are firm and time subscripts respectively.

Two versions of each model are estimated. In the first version, *remmeasure* is expressed as the mean bonus payment for the executive directors of firm i at time t .² This model is referred to as the ‘raw bonus’ model. In the second variation, *remmeasure* for equations (1) and (2) is an indicator variable that takes the value of one if managers are deemed to be overpaid, and zero otherwise. The technique used to construct the indicator variable is discussed in Section 3.3 below. This model is referred to as the ‘abnormal bonus’ model.

Disclosure Quality and Quantity

Existing studies relating political sensitivity to corporate disclosure focus exclusively on either quality (Clarkson et al., 2006) or quantity (Raffournier, 1999) or make no clear attempt to differentiate between the two concepts (Meek et al., 1995). The latter is especially problematic as disclosure quantity merely measures the amount of disclosure made, without assessment of the usefulness of the information provided. In contrast, disclosure quality measures the usefulness of the information to its users. Disclosure quantity is not a perfect substitute for disclosure quality: managers are able to hide useful information by concealing it among high volumes of uninformative disclosures. An underlying reason for the lack of research exploring disclosure quality is that it is particularly difficult to measure, due to its subjective nature. The most common approach involves defining quality against an external benchmark; based on the underlying notion that a third party benchmark of quality provides a degree of objectivity

from the perspective of the researcher (e.g. Clarkson et. al (2006). The approach used to measure disclosure quality in this study is described below.

Measuring Disclosure Quality

Muslu (2010) and Clarkson et al (2006) are used as guidance in constructing a disclosure quality measurement instrument, as both studies are related to remuneration disclosures. Both papers utilised indices measure the quality of remuneration disclosures. Clarkson et al (2006) based their index on the Australian Accounting Standard AASB 1046 – Director and Executive Disclosures by Disclosing Entities. Muslu (2010), meanwhile, used the following four criteria to measure disclosure quality: (i) overall compensation policy and goals; (ii) pay-setting guidelines for specific positions; (iii) executive compensation in previous years; and (iv) future determinants of executive compensation. He scored firms using the following method: firms that reported none of the above were awarded a score of zero; those that reported some of the above scored one; and those that reported all of the above scored two.

I follow the approach of Clarkson et al. (2006) and Muslu (2010) and construct an index of remuneration disclosure quality. To measure quality, a benchmark against which quality can be assessed should be ideally present. I draw on guidance provided by the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF) to help define what constitutes informative and high quality remuneration disclosures. I also use the disclosure requirements in the DRRR (2002) relating to long-term incentive plans as an additional benchmark for determining the informative content of disclosures relating to short-term plans. As the DRRR (2002) requirements are for

long-term incentive plans, some of the mandated disclosures are irrelevant for annual bonus plans. These include disclosures pertaining to share option grant and expiry dates, exercise price, and length of plan. However, other disclosure requirements for long-term incentive plans such as plan targets, terms and conditions triggering rewards, and the form of the reward are equally applicable to annual bonus plans as they are to long-term remuneration arrangements.

Using the above as a framework, I construct an index comprising the following five disclosure dimensions: performance measure disclosures, target disclosures, benchmark disclosures, reward disclosures, and other information. *Performance measure disclosures* consist of disclosures relating to the use of performance measures in the annual bonus plan, in particular disclosure of the performance measure itself and the corresponding performance period. *Target disclosures* refer to the use of performance targets and target thresholds, and disclosures of the actual targets and target thresholds used. Targets are set by management and upon attainment, trigger the rewards associated to them. *Benchmark disclosures* refer to the use and form of performance benchmarks, including details of peer groups used. Benchmark are measures against which targets are set against. For instance, a firm would set an eps growth target benchmarked against the growth in RPI. *Rewards disclosures* relate to the form of the reward or bonus, the amount of the reward or bonus, and whether the firm applies a cap on the level of bonus payments. Disclosures relating to participants in the scheme, weightings on different performance measures, the use of discretion in the scheme and any other additional information are captured in the other disclosures category. Further details are provided in the appendix.

To obtain index scores, annual bonus disclosures in the remuneration report are analysed for each firm using the criteria outlined in the appendix. A score of one is assigned if the disclosure item is present and zero otherwise. The aim of the index is to capture the informativeness of disclosures. For instance, in assessing disclosures relating to peer groups, a score of one is awarded if the disclosure mentions peer groups, whether firms employ them or not in the bonus plan, as this indicates that the firm at the very least considered the idea of peer groups, which is informative to the shareholder. A score of zero is only given when no mention is made of peer groups. Scores are aggregated for each of the five dimensions, and dimension scores are then totalled to obtain the firm disclosure quality score.

The scores were then normalised, following Bertrand and Mullainathan (2001). This is calculated as follows: the sample mean and standard deviation for each dimension (Performance Measure, Target, Benchmark, Reward and Other) is computed. Each dimension score for each firm (firm-dimension score) is then normalised by subtracting the dimension sample mean from each firm-dimension score and dividing by the dimension sample standard deviation. The final score is then obtained by summing across the five normalised dimension scores. The main advantage of this method is that it normalises the score for each dimension. This eliminates any bias that may result from having an unequal number of items in a dimension.

In addition, I also calculate the disclosure score using two alternative methods, which are used as sensitivity tests in Section 5.2. These methods, as well as a detailed explanation of the scoring process for a randomly selected firm, are presented in Appendix A.

Measuring Disclosure Quantity

Disclosure quantity captures the total volume of information disclosed concerning remuneration practices. This is defined as a relative quantity measure, where the number of pages in the remuneration report is scaled by the total number of pages in the annual report. I use a scaled metric to control for the fact that large firms disclose more (Lang and Lundholm, 1993). A similar approach was employed by Cowan et al. (1987) to measure the quantity of social responsibility disclosures.

Political Sensitivity

As discussed in the literature review section, firm size has been widely used in the accounting literature to measure political sensitivity (Watts and Zimmerman, 1978; Raffournier, 1995; Oliviera et al, 2005; Meek et al, 1995). However, this approach is problematic because firm size captures a multitude of other factors (Ball and Foster, 1982, Meek et al, 1995; Cormier et al, 2005). It also may fail to capture elements specific to executive remuneration. The approach taken in this paper is aimed at overcoming these limitations.

I measure political sensitivity using managerial remuneration data, measured as the average annual bonus payments computed for executive board members of firm i at time t . I use raw (actual) bonus payments as well as unexplained (excessive) bonus, following on from Baker (1999) who established that excessive executive remuneration increased firms' political costs. I estimate excessive executive bonuses using the following model:



(3)

where *pay* is the bonus for firm *i* at time *t*; ³ *perform* is firm *i*'s performance measured using 12-month share returns and return on equity; ⁴ and *firmsize* is measured using beginning-of-period market capitalisation. This approach is similar to the procedure used by Yermack (1998) and Agrawal and Walking (1994), where over- (or under-) payment is measured using the residuals from a regression of pay against performance factors, after controlling for size and industry membership. I estimate regression (3) using ranks rather than raw values to minimise the impact of extreme observations (Iman and Canover, 1979). I use η to construct an indicator variable for excessive bonus payments that takes the value of one when $\eta_{it} > 0$ and zero otherwise. The indicator variable is then used as *remmeasure* variable in equations (1) and (2). While principal tests measure political sensitivity using bonus payments to ensure consistency with the aspect of disclosure being analysed, in supplementary tests I also construct political sensitivity proxies using salary, total cash benefits, and total cash remuneration (i.e., salary plus cash bonus plus cash benefits).

Control Variables

Disclosure Propensity

Propensity to disclose controls for firms' overall disclosure strategy (Lang and Lundholm, 1993; Clarkson et al., 1999). I measure disclosure propensity as the natural log of the total number of pages in the annual report and accounts (including summary

reports, corporate social disclosure reports and other related items published at time t following Clarkson et al., 2003; Li et al., 1997; and Scott, 1994).

Remuneration consultants

Evidence indicates that when firms engage an external advisor, there is an observable effect on the quality of related outputs. For example, Dunn and Mayhew (2004) find that the use of audit firms that have specialist knowledge of certain industries is positively related to clients' disclosure quality, while Defond and Jiambalvo (1991) find that clients of major audit firms are less likely to have irregularities in the financial statements, suggesting that advisor identity could affect output quality. Bebachuk et al. (2002) meanwhile argue that the use of advisors such as remuneration consultants could help firms camouflage rent extracting activities during remuneration contract negotiations, thereby helping to minimise outrage costs. The DRRR (2002) requires firms to disclose the identities of remuneration consultants used during the reporting period. Using this information I construct an indicator variable to proxy for the use of a remuneration consultant.

Size and Industry

Prior research suggests that disclosure quantity and quality vary by industry (e.g., Meek et al, 1995). I use a vector of industry dummy variables to control for sector membership, based on Datastream's Level-3 Industry Classification. Research also documents that firm size affects the quality and quantity of disclosures that firms make (Chow and Boren-Wong, 1987, Zimmerman, 1983; Meek et al, 1995). Ceteris paribus,

larger firms are expected to have greater resources to provide more disclosures and disclosures of a higher quality. However, as Ball and Foster (1982) discuss, it is unclear what size actually captures. I used beginning-of-period market capitalisation to proxy for firm size.

Prior work has not distinguished between disclosure quality and disclosure quantity, making it difficult to assess whether variables drive disclosure quality, disclosure quantity, or both. Therefore, I employ similar control variables for the disclosure *quality* model and the disclosure *quantity* model. I control for the volume of disclosure in the disclosure *quality* model as firms that disclose more are likely to disclose better quality information. In the disclosure *quantity* model, I omit this control variable as it is equal to the dependent variable. While this may raise endogeneity issues, I do not see this affecting the model, as disclosure quantity is only used as a control variable. Accordingly, the control variables for the disclosure *quality* model are firm size, use of compensation consultants, firm propensity to disclose, and disclosure quantity; and the control variables for the disclosure *quantity* model are firm size, use of compensation consultants and firm's propensity to disclose.

4. Sample, Data Collection and Descriptive Statistics

Sample Selection

The sample for this study is 440 largest London Stock Exchange-listed firms (excluding investment trusts) ranked by market capitalisation on 31 January 2003. Firms were ranked at January 2003 because the Directors' Remuneration Report Regulations (2002) came into effect for financial years ending on or after 31 December 2002, meaning that remuneration reports published in 2003 (relating to the 2002 fiscal year)

were the first to comply with the new disclosure requirements. From this, forty firms were dropped due missing annual bonus plan information and missing outstanding shares and share price information on Datastream. The final sample therefore comprises 400 firms each with annual bonus plans.

Data

Annual bonus plan data required to compute the disclosure quality index are manually extracted from the annual bonus section of the remuneration report in each firms' published annual report and accounts. Cash remuneration data including salary, cash bonuses, cash benefits, and other cash remuneration for all executive members of the board are obtained in the first instance from Manifest Ltd. Compensation data are missing from the Manifest dataset for 43 firms. For these cases, data were hand collected from the remuneration report section of the corresponding firm's published annual report and accounts.

Market capitalisation data (calculated using share price and number of outstanding shares) are collected from Datastream. Industry classifications are also obtained from Datastream. The identities of remuneration consultants employed during the reporting period are collected manually from the remuneration report as the DRRR (2002) requires firms to disclose the identity of all remuneration consultants used during the period. I also manually collect the number of pages in the remuneration report in the annual report.

Descriptive Statistics

<TABLE 1 ABOUT HERE>

Descriptive statistics for sample firms are presented in Table 1, which reports the distribution of firms by industry and balance sheet dates for firms in the sample, together with the percentage of firms that use remuneration consultants. The sample is characterised by a degree of clustering, with 35.75% of firms operating in the cyclical services industry. The next largest industry is the finance sector with 18.75%. Although cyclical services (26.12%) and finance (11.93%) are the two largest industries represented in the Datastream universe respectively, they are overrepresented in my sample. Almost half (45.75%) of firms have 31 December year-ends.

Panel A of Table 2 reports descriptive statistics for the disclosure quality index. The maximum score is 9.80, while the mean (median) is -0.02 (0.76). Performance measures are the most transparently reported item, with sample firms disclosing at least one item measured in the index. In the target, benchmark and reward disclosure dimensions, more than half of the scored items are disclosed by the firms, whereas for the Other Disclosures category, disclosure is poor with less than half the listed being disclosed. The three items characterised by the poorest disclosure are the weightings of the different performance measures, disclosures concerning managerial discretion in the award of bonuses, and disclosures concerning the use of peer groups. There is some moderate variance in the scores. , and this is consistent across all methods of index score calculations.

<TABLE 2 ABOUT HERE>

Panel B of Table 2 presents descriptive statistics for the explanatory variables used in models (1) and (2). The mean (median) firm has a market capitalisation of £462m (£33m) and publishes an annual report with 69 (64) pages, of which 7 (6) are devoted to

the remuneration report. The mean (median) firm pays executive board members an average of £1.09 million (£0.92 million) in salary, £542,397 (£320,000) in bonuses and £1.89 million (£1.48 million) in total cash remuneration. The median firm also employs a compensation consultant.

These levels are higher than those reported by Conyon and Murphy (2000) but comparable to those presented by Conyon et al (2006) using more recent data. Conyon and Murphy (2000) report median CEO salary of £240,000 and average median CEO bonus of £91,000. Conyon et al. (2006) report average CEO total pay (total cash pay, shares, option grants and other pay) of £2.23 million. ⁵

The standard deviation and the difference between the mean and medians of variables such as total cash remuneration and market capitalisation suggest that there are large outliers in the data. While omitting these outliers would help limit their impact on subsequent empirical tests, trimming reduces the richness of the observations in the sample. I therefore use rank regressions to control for extreme observations without deleting any observations. Rank regressions involve ranking all observations for each variable and then estimating OLS regressions on the rank-transformed data. This approach was advocated by Iman and Conover (1979), who show that in data sets where outliers cannot be ignored, other regression techniques such as rank regressions are preferable.

5. Analysis

This section examines the relation between firm political sensitivity (proxied by average executive bonus) and the quality and quantity of annual bonus plan disclosures

in the remuneration reports of 400 large UK firms listed on the London Stock Exchange for the financial year of 2002. I report the main regression results in Section 5.1 and additional sensitivity analyses in Section 5.2.

Preliminary Results

Table 3 reports regression summary statistics and coefficient estimates for the disclosure quality and disclosure quantity rank regression models. The raw pay estimations (column 2 for disclosure quality and column 4 for disclosure quantity) measure political sensitivity as the average bonus per executive director. The unexplained pay estimations (column 3 for disclosure quality and column 5 for disclosure quantity) measure political sensitivity as the overpayment of bonuses conditional on firm performance. Disclosure quality is measured using the normalised disclosure quality index score.

<TABLE 3 ABOUT HERE>

Results indicate a significant negative relation between disclosure quality and political sensitivity for both raw and unexplained pay estimations, with coefficients of -0.109 (p-value: 0.05) for the raw pay estimation and -0.123 (p-value: 0.04) for the unexplained pay estimation (All probability values relate to two-tailed tests unless otherwise stated). Meanwhile, for the disclosure quantity model, I observe a positive and significant relation between disclosure quantity and political sensitivity for both estimations, with coefficient estimates of 0.096 (p-value: 0.02) for the raw pay estimation and 0.105 (p-value: 0.02) for the unexplained pay estimation.

The results of the regressions have interesting implications. Political cost theory predicts that firms that are more politically sensitive provide higher quality (more information) disclosures to minimise potential political costs. In contrast, I observe a negative and significant relation between political sensitivity and disclosure quality exists. These findings imply that as political sensitivity in the form of higher bonus payments increases, disclosure quality declines and the degree of opacity increases. At the same time, the positive and significant relation between disclosure quantity and political sensitivity implies that politically sensitive firms provide more disclosures. This result is consistent with political cost theory and managerial power theory, both of which predict that firms facing higher political visibility provide more information in an attempt to minimise political costs.

Overall results suggest that when firms are faced with high political costs associated with executive remuneration, management tend to provide a larger volume of disclosure concerning annual bonus plans but at the same time these disclosures tend to be of lower quality. It also underlines the need to differentiate between disclosure quantity and disclosure quality when it comes to studying voluntary disclosure, as the results of this paper suggests that they are two different measures.

There is little direct guidance in extant literature which maps perfectly onto the work in this study which could help explain these findings. Meek et al. (1995) found a positive and significant relation between political sensitivity and disclosure. However, their results are difficult to interpret for several reasons. First, their study did not extend to voluntary disclosures relating to executive remuneration. Second, they did not differentiate between disclosure quality and disclosure quantity. Clarkson et al. (2006),

meanwhile, found that for CEO remuneration disclosures of Australian firms, disclosure quality was positively and significantly related to two measures of political visibility: firm size and public scrutiny. However, they attribute this to detailed black letter legal requirements as opposed to principles-based legislation (Clarkson et al, 2006).

Both the disclosure quality and the disclosure quantity models control for the effects of remuneration consultants, firm size and industry effects. Studies by Defond and Jiambalvo (1991) and Dunn and Mayhew (2004) find that the use of external consultants affects disclosure quality. I find an insignificant advisor effect on disclosure quality, but a highly significant relation (p -value >0.001 for all models) between disclosure quantity and the presence of a remuneration consultant. These findings suggest that firms employing remuneration consultants provide more extensive bonus-related disclosures but this does not necessarily translate into higher (i.e., more informative) disclosure quality. Bebchuk et al. (2002) contend that the lack of an arms' length transaction environment between advisors (remuneration consultants) and management may help the latter to camouflage rent extraction activities. To the best of my knowledge, no previous research provides evidence on how the use of remuneration consultants impact disclosure quality and quantity.

The estimated coefficient on firm size is generally positive and significant in both the disclosure quality and quantity regressions. This result is consistent with previous research documenting a significant positive relation between size and disclosure (e.g., Meek et al., 1995; Raffournier, 1999). In previous studies, size is used to explain political sensitivity. In the models used in this paper, other proxies (executive remuneration) are used to capture political sensitivity relating specifically to bonus payments, but the

significant size effect corroborates various arguments that size is a convoluted measure that has various explanations. While it proves that firm size affects disclosure quality and quantity, size may also capture items such as information production cost or analyst monitoring (Meek et al, 1995; Ball and Foster, 1982). However, the political costs associated with bonus-related payments are incrementally significant beyond more general political factors captured by firm size.

Partial F-tests for the vector of industry dummy variables in the raw (unexplained) disclosure quality model have p-values of 0.633 (0.802), and 0.468 (0.674) for the disclosure quantity model. These statistics indicate that no significant variation in disclosure quality and quantity across industry sectors. Adjusted R-squareds are 0.039 for the raw and unexplained estimations of the disclosure quality model, and 0.485 and 0.488 for the raw and unexplained pay estimations of the disclosure quantity model, respectively. The disclosure quantity models have higher adjusted R-squareds compared to the disclosure quality models, which can be explained by the large size effect in the disclosure quantity regressions.

With reference to extant theory, results reported in Table 3 seem more consistent with managerial power theory than political cost theory. Managerial power enables managers to award themselves larger bonuses for a particular level of performance because managerial power negates the need for them to bargain their remuneration contracts at arm's length. Managerial power theory suggests that having done so, management then look to minimise outrage over their rent extraction activities (excessive bonus payment) by camouflaging information through a higher volume of disclosures. In

contrast to the predictions of political cost theory, disclosure quantity increases with political sensitivity but disclosure quality decreases as political sensitivity increases.

Sensitivity Tests

I test the robustness of my results using alternative specifications of disclosure quality, which is discussed in Section 5.2.1, and alternative specifications of political sensitivity as described discussed in Section 5.2.2.

Alternative Specifications of Disclosure Quality

Table 4 presents regression estimates using alternative specifications of disclosure quality. Similar to the main regression results, there exists a negative and significant relation between disclosure quality and political sensitivity for both raw and unexplained models regardless of whether disclosure quality is measured using total score, where p-values of 0.026 and 0.021 are reported for raw and unexplained respectively, or percentage score, where p-values of 0.027 and 0.030 are reported for raw and unexplained respectively. All tests are two-tailed unless otherwise indicated. These results indicate that results reported in Table 4 are robust to alternate methods of measuring disclosure quality.

<TABLE 4 ABOUT HERE>

Results for the control variables are also robust to the alternative methods of disclosure quality measurement. Size is significant at the 10% level for the raw models under both total score and percentage calculation methods, and marginally close to significant for the unexplained variables, with p-values of 0.182 and 0.119 respectively. The presence of a remuneration consultant has no statistically significant effect on

disclosure quality for both calculation methods under both models. I also observe no significant variation in disclosure quality across industry sectors when alternative specifications of disclosure quality are employed.

Alternative Specifications of Political Sensitivity

My main analysis uses annual bonus payments to proxy for political sensitivity. As an additional test, I use other forms of remuneration, namely salary, total remuneration and cash benefits as proxies for political sensitivity. As the study focuses on the disclosure of annual bonus schemes, it is interesting to see whether political sensitivity of the other components of executive pay also affects the level and quality of disclosures made relating to bonus payments.

<TABLE 5 ABOUT HERE>

Panel A of Table 5 presents regression results when annual bonus is replaced by salary. Columns 2 and 4 present the results of the raw pay estimations, and Columns 3 and 5 present the results of the unexplained pay estimations. Intuitively, I would expect that salary is less significantly related to the levels of annual bonus disclosures, and therefore a significant relationship does not exist. Accordingly, I observe that the relation between disclosure quality and political sensitivity as proxied by average salary is negative and insignificant for the raw pay estimation and is negative and significant (0.100) when estimated as unexplained pay. I observe similar relationships when salary is expressed as industry adjusted salary, but the relation is negative and insignificant when salary is expressed as the salary of the highest paid director. Different specifications of

disclosure quality (not presented in the tables) also yield a negative and insignificant relation for both raw and unexplained salary estimations.

Similarly for the disclosure quantity models, the relation between disclosure quantity and political sensitivity is positive and insignificant when political sensitivity is measured as the raw average salary per executive director, (0.108) but is weakly significant when measured as the unexplained salary (0.087).

Panel B of Table 5 presents the regression estimations when political sensitivity was measured using total cash remuneration. Total cash remuneration is defined as salary plus bonus plus benefits plus other cash remuneration items. Intuitively it is expected that total remuneration is highly sensitive to public scrutiny, and I expect to see a significant relationship between political sensitivity and disclosure quality and quantity. The results are consistent with the intuition. The relationship between disclosure quality and political sensitivity is significantly negative for both the raw (0.037, two-tailed) and unexplained pay (0.009, two-tailed) estimations. The observed relation between disclosure quality and political sensitivity above are robust to alternative calculations of the disclosure quality index (not reported in tables). The relation between disclosure quantity and political sensitivity when measured as average total cash remuneration is significant and positive for both the raw (0.0004, two tailed) and unexplained pay (0.003, two tailed) estimations.

Table 5 Panel C shows the results of the regression model when political sensitivity is measured using raw and excess average benefits per director. As benefits are specified in the remuneration contract and is often a contractual obligation, it is rarely contingent on performance. As such, it is not expected that benefits would show any significant relationship with disclosure quality or disclosure quantity.

On the whole, the results are insignificant with mixed signs. Disclosure quality is negative and insignificantly related to political sensitivity when specified as raw benefits, but positively and insignificantly related to political sensitivity when specified as excess benefits relative to performance. The relation between disclosure quantity and political sensitivity are positive and insignificant when political sensitivity is measured using raw and unexplained average benefits.

6. Summary and Conclusion

This paper discusses the impact of political sensitivity on the quality and quantity of annual bonus plan disclosures in a sample of 400 large UK firms. Running two separate regression models, one for disclosure quality and one for disclosure quantity, I find that disclosure quantity increases with political sensitivity, but disclosure quality decreases as firms become more politically sensitive. This contradicts with political cost theory, which is often used to explain the relationship between political sensitivity and disclosure. However, this observation fits with the managerial power theory, which suggests that firms have incentives to obfuscate their rent extracting activities for as long as they possibly can. The findings suggest that managers mask their rent extraction activities, in this case, excessive remuneration, by providing high volume but low quality disclosures. I find this observation to be generally robust across different disclosure quality index scoring techniques and different measures and specifications of political sensitivity.

This paper adds to existing literature in the following ways. First, I extend prior work in the disclosure and political sensitivity area by providing evidence on how the

quality and quantity of voluntary executive remuneration disclosures vary in relation to how politically sensitive managerial pay is. Earlier papers have provided evidence on other forms of voluntary disclosure relate to political sensitivity, albeit testing for political sensitivity as part of a larger set of variables (Meek et al, 1995; Cormier et al, 2005). This is the first study, to the best of my knowledge that studies executive remuneration disclosure in the same manner.

Second, in this study I separate disclosure quality and disclosure quantity, an approach that has yet to be used in one study at the same time. Earlier work have either focused on either disclosure quantity or disclosure quality (Raffournier, 1999) or as in the case of Meek et al. (1995), is vague as to which aspect of disclosure is actually being studied. This separation leads onto the third contribution of the paper, which is the use of managerial power theory to explain the relation between disclosure and political sensitivity. Prior studies have focused political cost theory to explain this relationship. In this paper the different observations for the relationship between disclosure quality and disclosure quantity and political sensitivity suggests that managerial opportunism cannot be discounted as an explanation for the varying levels of voluntary disclosures made.

The limitations of this study are as follows. First, a more refined way of measuring disclosure quality needs to be established. Prior papers have self-constructed indices to gauge disclosure quality (Raffournier, 1999; Clarkson et al. 2006), and each index constitutes of different measures which the authors perceive have information content to the users. The disclosure quality regression estimates yield a low adjusted r-squared figure, which may be of some cause for concern.

Second, while firms can and do obfuscate their activities by providing low quality disclosure information, this can only be done up to a point where the costs of disclosure are greater than potential outrage costs. We still do not know where this point lies. It is probable that this point exists at different levels for different groups of disclosures, and this may well vary from time to time, subject to factors such as the availability of information from other sources and current political climate.

Future studies could look at refining the disclosure quality measuring process, perhaps using more sophisticated techniques such as content analysis. Also, it would be interesting to apply the same tests for other voluntary disclosures, such as environmental reports and corporate social responsibility disclosures, to see if managerial power theory extends to these disclosures as well.

APPENDIX
Disclosure Index Dimensions and Calculation Methods

The disclosure index is calculated based on the following dimensions:

Performance Measures	Targets	Benchmarking	Targets	Other Disclosures
Use of performance measures	Use of performance targets	Benchmarking Firm Performance	Use of performance targets	Participants of the scheme
The actual performance measure	Use of target thresholds	Identity of Benchmarks	Use of target thresholds	Weightings on different performance measures
The related performance period	The actual target	Use of Peer Groups	The actual target	Discretionary elements of the scheme
	The actual thresholds		The actual thresholds	Any other additional information

An example of the disclosure index scoring process for Aegis plc is detailed below:

Annual Bonus Disclosure Statement, Aegis plc Annual Report 2003

All of the executive directors participate in the Group's Annual Cash Bonus Scheme based upon achievement of individual objectives and financial targets (profit before tax and management charges) linked to Group and, in the case of directors with operational responsibilities, regional performance. This may result in the payment of cash bonuses of up to 25% of base salary for on-target financial performance, with the opportunity to earn higher bonuses for exceptional performance up to 75% of base salary (100% for the Chief Executive Officer).

Additional, the executive directors with operational responsibilities (Adrian Chedore and David Verklin) participate in a separate deferred annual cash bonus scheme based on achievement of a demanding year on year excess profit above target financial performance of the businesses for which they are responsible. The payment of half of any such bonus is deferred for one year. This deferred bonus will normally be forfeited in the event that the director leaves the Group.

Performance Measures	Score for Aegis plc	Targets	Score for Aegis plc
Use of performance measures	1 - firm discloses usage of individual objectives and targets, so performance measures are present	Use of performance targets	1 – implied from the statement that bonus is based on achievement of financial targets
The actual performance measure	1 – individual objectives and financial measures	Use of target thresholds	1 – on target paid 25%, exceptional capped at 75% with 100% for CEO
The related performance period	1 – annual bonus is assumed to be one year unless otherwise stated	The actual target	0 – actual target figure is not disclosed
		The actual thresholds	0 – actual target thresholds are vague: says 'up to 25%' but not clear what the minimum threshold is.
Total Score for Dimension	3	Total Score for Dimension	2

Benchmarking	Score for Aegis plc	Rewards	Score for Aegis plc
Benchmarking Firm Performance	0 – no indication of any benchmarks used	The form of the reward / bonus	1 – cash payment is disclosed
Identity of Benchmarks	0 – no indication of benchmarks used	The amount of the reward / bonus	0 – actual reward amount not disclosed
Use of Peer Groups	0 – no indication of use of peer groups	A cap on the reward / bonus	1 – reward is capped at 75%
Total Score for Dimension	0	Total Score for Dimension	2

Other Disclosures	Score for Aegis plc
Participants of the scheme	1 – all executive directors participate in the scheme
Weightings on different performance measures	0 – no disclosure present
Discretionary elements of the scheme	1 – 'Exceptional performance' which warrants rewards maximised at the cap is not defined. This implies discretionary awards are possible.
Any other additional information	0 – no additional information present that would help shareholders understand the bonus scheme better.
Total Score for Dimension	2

These scores are then calculated using the normalised, total score and percentage techniques:

Normalised Method		
<p>The normalised score is calculated in two steps. The mean and the standard deviation is computed for each dimension (Performance Measure, Target, Benchmark, Reward and Other) are. Then, all dimension scores for each firm (firm-dimension scores) are added, and then normalised by subtracting the dimension mean from each firm-dimension score and dividing it by the standard deviation. The final score is then obtained by adding each firm-dimension score for each firm. The main advantage of using this method is that it normalises the score for each dimension, thereby eliminating any bias of one dimension having more items than others. This follows Bertrand and Mullainathan (2001)</p>	<i>Performance Measure Dimension</i>	
	Total Score	3
	Mean	2.902
	Standard Deviation	0.319
	Normalised Score	0.031
	<i>This is repeated for every dimension</i>	
	Other dimension scores	
	Targets	-0.082
	Benchmarking	-2.842
	Rewards	0.249
	Other	0.929
	Total Normalised Score	

Total Score Method		
<p>Total score is calculated computing the dimension score for each firm by dimension (firm-dimension scores), and then adding all firm-dimension scores together to obtain the firm score. This follows Gompers, Ishii and Metrick (2003)</p>	Performance Measure	3
	Targets	2
	Benchmarking	0
	Rewards	2
	Other	2
	Total Score for the firm	

Percentage Method		Total Score	Max Score	%	Equal Weight	Weighted Score
<p>Under the equal-weighted method, each dimension is assigned equal weighting. As there are five dimensions, each dimension is assigned a weighting of 20% (0.20). Each firm dimension score is adjusted by this weight and then, weigh-adjusted firm-dimension scores are summed to obtain a firm score, which ranges between 0 at the minimum and 1 at the maximum. This follows Black et al (2006).</p>	Performance Measure	3	3	1.00	0.20	0.20
	Targets	2	4	0.50	0.20	0.10
	Benchmarking	0	3	0.00	0.20	0.00
	Rewards	2	3	0.67	0.20	0.13
	Other	2	4	0.50	0.20	0.10
	Total Score for the firm					

NOTES

¹ This included firm remuneration policy on matters such as pay levels, comparator groups, performance criteria, pensions, service contracts and early termination

² This measure is not scaled by firm size although it was initially considered, as the regression is already controlled for size.

³ In sensitivity tests, bonus is substituted with salary, total cash remuneration and benefits respectively

⁴ Sloan (1993) suggests that a mixture of accounting and market based measures best reflect a firm's performance, and both should be used in evaluating firm performance.

⁵ Translated from the US\$ data at the exchange rate £1 = US\$ 1.6355

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TABLE 1
Descriptive Statistics of Sample Firms

Panel A : Distribution of Financial Year Ends, Industry and Advisor Use of Firms in the Sample								
Date	Financial Year End		Industry	Industry		Advisors	Advisors	
	Firms	%		Firms	%		Firms	%
31-Dec-02	10	2.50%	BASIC	44	11.00%	No	87	21.75%
31-Jan-03	14	3.50%	CYCGD	6	1.50%	Yes	313	78.25%
28-Feb-03	6	1.50%	CYSER	143	35.75%			
31-Mar-03	97	24.25%	GENIN	37	9.25%			
30-Apr-03	15	3.75%	ITECH	19	4.75%			
31-May-03	3	0.75%	NCYCG	38	9.50%			
30-Jun-03	22	5.50%	NCYSR	15	3.75%			
31-Jul-03	7	1.75%	RESOR	10	2.50%			
31-Aug-03	6	1.50%	TOTLF	75	18.75%			
30-Sep-03	31	7.75%	UTILS	13	3.25%			
31-Oct-03	6	1.50%						
30-Nov-03	0	0.00%						
31-Dec-03	183	45.75%						

The table presents the distribution of financial year ends, industries and the use of remuneration consultants by sample firms. Financial Year End was manually collected from annual reports. Industry categories are Datastream Level 3 Industries, where BASIC is basic industries, CYCGD is cyclical goods, CYSER is cyclical services, GENIN is general industries, ITECH is information technology, NCYCG is non-cyclical goods, NCYSR is non-cyclical services, RESOR is natural resources and mining, TOTLF is finance and UTILS is utilities. Firm use of remuneration consultants (advisors) were manually collected from the remuneration reports of the respective firms.

TABLE 2
Descriptive Statistics of Variables Used in Regression Estimates

Panel A: Disclosure Quality Score		Mean	Std Dev	Lower Quartile	Median	Upper Quartile
Normalised Index Score	Total	-0.020	2.730	-1.880	0.760	2.310
	<i>PerfMeas</i>	0.000	1.010	0.300	0.300	0.300
	<i>Tgt</i>	0.010	1.010	-0.810	0.440	0.440
	<i>Bmark</i>	0.010	1.020	-1.150	0.540	0.540
	<i>Rwd</i>	0.000	1.000	0.250	0.250	0.250
	<i>Oth</i>	0.000	1.000	-0.470	-0.470	0.930

Panel B: Explanatory Variables		Mean	Std Dev	Lower Quartile	Median	Upper Quartile
ARPages		68.77	24.64	54	64	76
RR Pages		6.82	2.66	5	6	8
RRinAR		0.1	0.03	0.08	0.1	0.12
CompCons		0.78	0.41	1	1	1
TCR ('000)		£1,886	£1,475	£997	£1,481	£2,321
Cash Bonus ('000)		£542	£843	£115	£320	£634
Salary ('000)		£1,093	£669	£642	£924	£1,295
Market capital (millions)		£4,616	£40,515	£142	£331	£1,080

Panel A presents the descriptive statistics of the disclosure quality index. The index comprises of five dimensions, *Perfmeas* (performance measurement disclosures), *Tgt* (target disclosures), *Bmark* (benchmark disclosures), *Rwd* (reward disclosures) and *Oth* (other disclosures). The index score is calculated by demeaning each firm dimension score. All disclosure information were obtained from the annual bonus plan disclosure section of the remuneration reports and manually coded. See Appendix for individual breakdown of disclosure items in each dimension. Panel B presents the descriptive statistics of the explanatory variables used in the study. The sample consists of 400 large UK-listed firms (not including investment trusts) measured by market capital as at 31 January 2003. All annual reports are from the fiscal year of 2002. *ARPages* is the number of pages of the annual report. *RRPages* is the number of pages of the remuneration report in the annual report. *RRinAR* is the percentage of the remuneration report as a fraction of the full annual report. *CompCons* is an indicator variable that takes a value of one if the firm uses a compensation consultant and zero otherwise. *TCR* is total cash remuneration, which is the sum of the average salary, cash bonus and benefits per director for the 2002 fiscal year paid by the firm. *Cash Bonus* and *Salary* are average cash bonuses and salaries per director for the fiscal year 2002. All remuneration data were obtained from Manifest, and in the event of missing items, manually collected from remuneration reports. *Market Capital* is measured using the closing share price as at firm balance sheet date, multiplied by the number of outstanding shares on the same date. Both data were collected from Datastream.

TABLE 3
Rank Regression Results

Political Sensitivity and Disclosure Quality & Disclosure Quantity				
	Disclosure Quality		Disclosure Quantity	
	Raw	Unexplained	Raw	Unexplained
intercept	277.67 (0.133)	242.682 (0.175)	-85.199 (0.526)	-50.139 (0.699)
<i>remmeasure</i>	-0.109 (0.056)	-0.123 (0.038)	0.096 (0.019)	0.105 (0.015)
<i>lnmktcap</i>	0.118 (0.068)	0.091 (0.155)	0.177 (<.0001)	0.199 (<.0001)
<i>advisor</i>	0.111 (0.150)	0.098 (0.203)	0.231 (<.0001)	0.229 (<.0001)
<i>disclosure</i>	-0.001 (0.999)	-0.006 (0.927)	0.446 (<.0001)	0.448 (<.0001)
<i>percentrr</i>	-0.049 (0.347)	-0.05 (0.347)		
Industry dummies	Yes	Yes	Yes	Yes
Partial F-test p-values (industry)				
	0.633	0.802	0.469	0.674
Rsq	0.072	0.073	0.501	0.505
Adjrsq	0.039	0.039	0.485	0.488

The table presents the coefficients and p-values (in parentheses) from the OLS rank regressions to assess the relation between political sensitivity and disclosure quality and quantity. Disclosure Quality is measured using normalised index scores. Disclosure Quantity is measured using the percentage of remuneration report pages in the annual report. *remmeasure* is the rank of average cash bonus payments per director, proxying for political sensitivity, expressed as raw (columns 2 and 4) and unexplained (columns 3 and 5). The raw regressions are estimated by using the absolute amount of average cash bonus payments as *remmeasure*. The unexplained regressions are estimated by constructing *remmeasure* to be an indicator variable. The indicator variable is computed by regressing average cash bonuses against performance, where a positive residual value indicates overpayment (denoted as one) and a negative residual value indicates underpayment (denoted as zero). *lnmktcap* is the rank of the natural log of market capital, computed by multiplying the closing share price by the number of shares outstanding as on the balance sheet date. *advisor* is the rank of the indicator variable that takes a value of one if a firm employs a compensation consultant, and zero otherwise. *disclosure* is the rank of the firms' annual report and related disclosure pages, which proxies for firms' propensity to disclose. *percentrr* is the rank of the percentage of remuneration report pages as a fraction of pages in the annual report. The regression is controlled for industry, and partial F scores test for the variation in disclosure quality and quantity in different industries.

TABLE 4

Rank Regression Results of Sensitivity Tests: Alternative Measures of Disclosure Quality

	Total Score		Percentage Score	
	Raw	Unexplained	Raw	Unexpl.
intercept	255.308 (0.158)	215.295 (0.220)	288.050 (0.109)	244.5195 (0.170)
<i>remmeasure</i>	-0.124 (0.026)	-0.134 (0.021)	-0.127 (0.027)	-0.129 (0.03)
<i>lnmktcap</i>	0.114 (0.070)	0.084 (0.182)	0.131 (0.042)	0.099 (0.119)
<i>advisor</i>	0.111 (0.143)	0.101 (0.184)	0.093 (0.226)	0.093 (0.228)
<i>disclosure</i>	-0.023 (0.721)	-0.030 (0.645)	-0.030 (0.649)	-0.032 (0.624)
<i>percentrr</i>	-0.047 (0.354)	-0.050 (0.341)	-0.055 (0.290)	-0.054 (0.300)
Industry Dummies	Yes	Yes	Yes	Yes
Partial F-test p-values (industry)	0.752	0.9584	0.611	0.8224
rsq	0.008	0.0791	0.0783	0.0778
adjrsq	0.005	0.0456	0.0448	0.0443

The table presents the coefficients and p-values (in parantheses) from the OLS rank regressions to assess the relation between political sensitivity and disclosure quality using alternative measure of disclosure quality. Disclosure Quality is measured using total scores in columns 2 and 3, and percentage score in columns 4 and 5. *remmeasure* is the rank of average cash bonus payments per director, proxying for political sensitivity, expressed as raw (columns 2 and 4) and unexplained (columns 3 and 5). The raw regressions are estimated by using the absolute amount of average cash bonus payments as *remmeasure*. The unexplained regressions are estimated by constructing *remmeasure* to be an indicator variable. The indicator variable is computed by regressing average cash bonuses against performance, where a positive residual value indicates overpayment (denoted as one) and a negative residual value indicates underpayment (denoted as zero). *lnmktcap* is the rank of the natural log of market capital, computed by multiplying the closing share price by the number of shares outstanding as on the balance sheet date. *advisor* is the rank of the indicator variable that takes a value of one if a firm employs a compensation consultant, and zero otherwise. *disclosure* is the rank of the firms' annual report and related disclosure pages, which proxies for firms' propensity to disclose. *percentrr* is the rank of the percentage of remuneration report pages as a fraction of pages in the annual report. The regression is controlled for industry, and partial F scores test for the variation in disclosure quality and quantity in different industries.

TABLE 5*Rank Regression Results of Sensitivity Tests: Alternative Measures of Political Sensitivity*

Panel A: Salary				
	Disclosure Quality		Disclosure Quantity	
	Raw	Unexplained	Raw	Unexplained
Intercept	258.258 (0.164)	248.22 (0.166)	-73.206 (0.587)	-50.867 (0.696)
<i>remmeasure</i>	-0.058 (0.312)	-0.109 (0.060)	0.067 (0.108)	0.072 (0.089)
<i>lnmktcap</i>	0.126 (0.063)	0.106 (0.098)	0.166 (0.0007)	0.189 (0.0007)
<i>advisor</i>	0.12 (0.122)	0.108 (0.164)	0.224 (<.0001)	0.224 (0.0007)
<i>disclosure</i>	-0.028 (0.662)	-0.029 (0.649)	0.465 (<.0001)	0.468 (0.0007)
<i>percentrr</i>	-0.059 (0.254)	-0.057 (0.277)		
Industry dummies	Yes	Yes	Yes	Yes
Partial F-test p-values (industry)	0.688	0.771	0.502	0.639
Rsq	0.066	0.071	0.497	0.501
Adjrsq	0.032	0.038	0.481	0.484
Panel B: Total Cash Remuneration				
	Disclosure Quality		Disclosure Quantity	
	Raw	Unexplained	Raw	Unexplained
Intercept	280.622 (0.128)	241.728 (0.176)	-104.673 (0.431)	-49.505 (0.702)
<i>remmeasure</i>	-0.125 (0.0366)	-0.153 (0.009)	0.151 (0.0004)	0.125 (0.003)
<i>lnmktcap</i>	0.142 (0.032)	0.097 (0.127)	0.141 (0.0032)	0.193 (<.0001)
<i>Advisor</i>	0.111 (0.151)	0.108 (0.1594)	0.23 (<.0001)	0.22 (<.0001)
<i>disclosure</i>	-0.005 (0.939)	-0.016 (0.7994)	0.442 (<.0001)	0.458 (<.0001)
<i>Percentrr</i>	-0.045 (0.392)	-0.046 (0.3788)		
Industry dummies	Yes	Yes	Yes	Yes
Partial F-test p-values (industry)	0.615	0.824	0.391	0.695

Rsq	0.074	0.079	0.51	0.508
Adjrsq	0.041	0.046	0.494	0.492

Panel C: Benefits

	Disclosure Quality		Disclosure Quantity	
	Raw	Unexplained	Raw	Unexplained
Intercept	236.944 (0.202)	233.468 (0.196)	-60.73 (0.653)	-52.831 (0.686)
<i>remmeasure</i>	-0.006 (0.902)	0.005 (0.928)	0.033 (0.375)	0.051 (0.221)
<i>Lnmtcap</i>	0.105 (0.104)	0.103 (0.108)	0.186 (<.0001)	0.191 (<.0001)
<i>Advisor</i>	0.116 (0.135)	0.106 (0.173)	0.23 (<.0001)	0.229 (<.0001)
<i>disclosure</i>	-0.036 (0.572)	-0.042 (0.517)	0.471 (<.0001)	0.471 (<.0001)
<i>Percentrr</i>	-0.063 (0.229)	-0.065 (0.213)		
Industry dummies	Yes	Yes	Yes	Yes
Partial F-test p-values (industry))	0.761	0.759	0.561	0.618
Rsq	0.063	0.063	0.495	0.499
Adjrsq	0.023	0.029	0.478	0.482

The table presents the coefficients and p-values (in parantheses) from the OLS rank regressions using alternative forms of remuneration to proxy for political sensitivity. Disclosure Quality is measured using normalised index scores. Disclosure Quantity is measured using the percentage of remuneration report pages in the annual report. Panel A presents the regression estimates when *remmeasure* is defined as average salary per director. Panel B presents the regression estimates when *remmeasure* is defined as average total cash remuneration per director, where total cash remuneration is the sum of salary, cash bonus and benefits. Panel C presents the regression estimates when *remmeasure* is defined as average benefits. *remmeasure* is expressed as raw (columns 2 and 4) and unexplained (columns 3 and 5). The raw regressions are estimated by using the absolute amount of the respective remuneration payments as *remmeasure*. The unexplained regressions are estimated by constructing *remmeasure* to be an indicator variable. The indicator variable is computed by regressing average cash bonuses against performance, where a positive residual value indicates overpayment (denoted as one) and a negative residual value indicates underpayment (denoted as zero). *lnmtcap* is the rank of the natural log of market capital, computed by multiplying the closing share price by the number of shares outstanding as on the balance sheet date. *advisor* is the rank of the indicator variable that takes a value of one if a firm employs a compensation consultant, and zero otherwise. *disclosure* is the rank of the firms' annual report and related disclosure pages, which proxies for firms' propensity to disclose. *percentrr* is the rank of the percentage of remuneration report pages as a fraction of pages in the annual report. The regression is controlled for industry, and partial F scores test for the variation in disclosure quality and quantity in different industries.