

International Conference on Accounting Studies 2014, ICAS 2014, 18-19 August 2014, Kuala Lumpur, Malaysia

The voluntary disclosure of Malaysian executive directors' remuneration under an evolving regulatory framework

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Abstract

This study examined the level of voluntary disclosure of executive directors' remuneration in Malaysia. The study period covered a period of significant changes in the Malaysian regulatory framework on disclosure over 2000 to 2008. It applied an un-weighted disclosure index to determine a voluntary disclosure score that was determined as score of excess of the mandatory disclosure requirements. The study found a significant improvement in the level of voluntary score after the introduction of the reforms. However, they appeared to be exploitation of the weaknesses in the reforms that limited their effectiveness in improving the disclosure of executive directors' remuneration.

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Peer-review under responsibility of the School of Accountancy, College of Business, Universiti Utara Malaysia.

Keywords: Executive remuneration; voluntary disclosure; corporate governance

1. Introduction

In Malaysia, the annual average income per capita for the year 2011 was RM 28 725 (Economic Planning Unit, 2011). On the other hand, an average remuneration of Malaysian executive director's in 2011 was RM 824 000 (Minority Shareholders Watchdog Group, 2011). The highest paid executive in 2010 was from Genting Berhad with a remuneration of RM 106 million (Chieh 2011). Although the level of Malaysian executive directors' remuneration was not as exorbitant as their American counterparts, there was serious concern about the minimal

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disclosure on remuneration policies and practices in the annual reports (Minority Shareholders Watchdog Group, 2011). It was difficult for shareholders to gauge the performance of the executive directors' in working for them and whether their remuneration was fair or excessive. It has not been surprising that a significant number of the pay and performance studies were done in the US where disclosure requirements had been extensive for some time. Andjelkovic et al. (2002) argued that the lack of disclosure meant that shareholders would not be able to scrutinize remuneration and to demand the board of directors place more emphasis on an association between pay and performance. The lack of scrutiny may mean that the board of directors would be lax in setting remuneration policies and disciplining executives.

1.1. Malaysian regulatory framework on disclosure of executive directors' remuneration

Table 1. Malaysian regulatory framework on disclosure.

Year	The changes or introduction of new regulations
1996	Introduction of a timeframe for full disclosure based regulations by the Securities Commission
2000	Disclosure of emoluments in the Companies Acts.
2001	Introduction to the Malaysian Code of Corporate Governance. Part 1(B) – link between remuneration and individual performance. Part 4(B) – disclosure of individual remuneration. Part 2(AA) – establishment of remuneration committee.
2001	KLSE (Bursa Malaysia) Listing Rule – the mandatory disclosure of directors' remuneration by bands
2005	Introduction of MFRS 2 Share based payment – additional disclosure on share based payments to employers inclusive of directors
2006	Introduction of MFRS 124 Related party disclosure – disclosure of remuneration of key management personnel

Prior to 2001, there was no regulation that specified or recommended good corporate governance practices. Much was left to capital market to self-regulate. The East Asian financial crisis of 1997 and 1998 brought attention to this glaring weakness. Subsequently, it led to the introduction of the Malaysian Code on Corporate Governance (MCCG) in 2001. It was recommended that companies disclose individual director's remuneration and a statement of the principles behind remuneration policies. The regulators adopted a 'hybrid method' or 'comply or justify' method of corporate governance in implementation of the MCCG. This gave companies discretionary power on the extent of their disclosure. The Bursa Malaysia Listing Rules were also amended to include mandatory disclosure of directors' remuneration by bands. This was followed by the harmonization of Malaysian accounting standards with the International Accounting Standards. The Financial Reporting Standard (FRS) 2 'Share based payments' was introduced in 2005. It required reporting entities to disclose details of executives' share based payments. The FRS 124 'Related party disclosure' was introduced in 1999 and was amended in 2005 to include disclosure of 'key management personnel' remuneration. These reforms were introduced to improve the level of transparency into the market and to restore investors' confidence in the Malaysian capital market. The question is whether these reforms are effective in improving the transparency of remuneration practices and policies in Malaysia.

2. Literature review and hypotheses developments

The objective of this study is to examine the level of disclosure of Malaysian executive directors' remuneration before and after the introduction of the reforms of the disclosure framework. Luo, Courtenay and Hossain (2006) argued that a disclosure rich environment like the US may not capture the influence of the theoretical determinants on the extent of disclosure. The adoption of an Anglo-American based corporate governance code in a developing Asian market with distinctive ownership and cultural characteristics, provides an interesting avenue in to study the extent and effectiveness of disclosure reforms. Chizema (2008) argued that the introduction of an Anglo-American corporate governance code that had been designed to maximise shareholders value may be resisted by institutional actors such as family owners and banks who had largely enjoyed controlling power over company policies. Prior studies have shown that corporations were resistant to the introduction of requirements to disclose details of executive remuneration especially individual remuneration and the valuation of executive options plans (Andjelkovic, Boyle, & McNoe, 2000; Chizema, 2008). This study will investigate whether there was similar resistance to the implementation of the reforms in Malaysian capital market and whether the reforms were

effective in improving the level of disclosure of executive directors' remuneration.

Earlier Malaysian studies focused on overall corporate governance measures (Zulkaflī, Abdul Samad, & Ismail, 2004) on factors that affect their implementation (Haniffa & Cooke, 2002; Mohd Ghazali & Weetman, 2006; Ngui, Voon, & Lim, 2008) on the actual compliance of Malaysian firms with the corporate reforms (Christopher & Hassan, 2005); and on the impact of adopting corporate governance measures on firms or on Malaysian market indices (Abdul Wahab, How, & Verhoeven, 2007; Aik Leng & Abu Mansor, 2005; Nowland, 2008). These studies did not focus on the disclosure of Malaysian executive directors' remuneration. Most of the studies examined the level of compliance after the introduction of the MCCG but did not consider the changes that followed the introduction of new accounting standards.

One might presume that a study that examined disclosure in a regulated market is futile given that companies are obliged to disclose information and may choose not to disclose beyond that requirement. However, Dye (1986) contended that the introduction of mandatory disclosure requirements can improve the extent of voluntary disclosure. Naser and Nuseibeh (2003) studied the level of compliance of Saudi Arabian listed companies with mandatory disclosure requirements and the extent of voluntary disclosure in these companies. They found a positive and significant correlation ($r=0.53$, $p<0.000$) between the level of mandatory and voluntary disclosure for the total sample. This leads to the hypothesis that:

H1: There was an improvement in the level of voluntary disclosure of executive directors' remuneration after the reforms in Malaysian regulatory framework

3. Methodology

3.1. Sampling

The sample period is from 2000 to 2008. This period covers the changes in the regulatory framework for directors' remuneration disclosure. The year 2000 is a barometer for the effects of the regulatory reforms on the extent of disclosure as there was no regulation prior to and during that year. The MCCG and KLSE listing rules on disclosure of remuneration by bands first applied in 2001. The FRS 2 'Share based payments' and FRS 124 'Related party transactions' were introduced in 2005 and 2006 respectively. The nine year period allows for a learning period so that companies can adapt to the reforms. After allowing for changes in fiscal years, a total of 1788 annual reports were collected for the 200 sample companies over the study period.

3.2. Voluntary disclosure score

The disclosure of executive directors' remuneration was measured by applying a scoring index that was derived from Malaysian regulatory framework. It contained mandatory disclosure items as required by the FRS 2 and the Bursa Malaysia Listing rule and additional and voluntary disclosure items derived from Malaysian FRS 124, Australian AASB 124 'Related party disclosure' and prior studies (Bassett, Koh, & Tutticci, 2007; Clarkson, Van Bueren, & Walker, 2006; Laksmana, 2008).

Subsequently, the voluntary disclosure score was derived from the excess score that the company received after discounting score obtained from mandatory disclosure requirements. The maximum total score inclusive of mandatory and voluntary items is seventeen for companies that issued executive options and fourteen for other companies. Both the maximum mandatory and voluntary scores evolved throughout the study period depending on the regulatory framework that was introduced progressively over the nine years.

Consistent with previous studies (Bassett, Koh & Tutticci 2007; Clarkson, P, Van Bueren & Walker 2006; Laksmana 2008), this study scores the disclosure items on a range of values instead of counting the words. Simply counting words may include repetitive sentences or lengthy but not meaningful sentences, and may exclude details provided by graphic representations and links to the number of directors in the board. Scoring based on values allows for the identification of minimum, maximum and excess values to distinguish between the mandatory and

voluntary disclosure of executive directors' remuneration.

The scoring was done manually by reading the annual reports in their entirety at first. The scoring was done on the second reading. Random and independent checks were done on at least 10% of the sample to ensure consistency in the scoring.

3.3. Hypothesis testing

As indicated by the Jarque-Bera test, the dataset that was obtained was skewed and the normality assumption is significantly rejected. This ruled out the validity of parametric tests. Thus, the hypothesis was tested by applying non-parametric median tests of Median χ^2 , Kruskal- Wallies and Mann-Whitney Wilcoxon. The null hypothesis of these tests is that there are no differences in the median or mean ranks (for Mann-Whitney Wilcoxon) of the subgroups.

4. Results and discussions

Table 2. Descriptive statistics for total voluntary score executive directors' remuneration score from the period 2000 to 2008.

Panel A					
	Mean	Median	Max	Min.	Std. Dev.
2000	0.1988	0.1429	0.6471	0.0000	0.0845
2001	0.4203	0.3846	0.8462	0.0769	0.1411
2002	0.4817	0.4615	1.0000	0.2308	0.1291
2003	0.5174	0.4615	1.0000	0.2308	0.1437
2004	0.5449	0.5385	1.0000	0.2308	0.1446
2005	0.5462	0.5385	1.0000	0.2308	0.1585
2006	0.5577	0.5385	1.0000	0.2308	0.1584
2007	0.5800	0.6154	1.0000	0.3077	0.1614
2008	0.6104	0.6154	1.0000	0.0769	0.1667
All	0.4949	0.4615	1.0000	0.0000	0.1864
Median χ^2 test = 283.3632 ***					
Kruskal – Wallis (tie-adj.) = 633.9115***					
Jarque-bera test = 15.4351 ***					
Panel B Result of Mann Whitney Wilcoxon(tie-adj) tests					
		Mean Rank	Mean score	Value	
YR 0001	2000	115.4650	-0.6509		
	2001	285.5350	0.6832	14.8433***	
YR 0008	2000	104.0350	-0.7310		
	2008	296.9650	0.7589	16.8513***	
YR 0108	2001	138.7225	-0.5060		
	2008	262.2475	0.5096	10.7199***	

** *Significant at 1% level

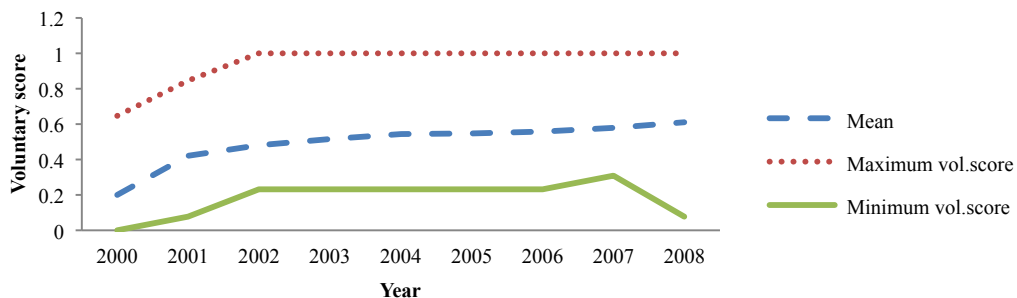


Fig. 1. Total voluntary score of disclosure executive directors' remuneration from 2000 to 2008.

The voluntary score measure consists of items that are reported in excess of the mandatory requirements of the Listing Rule and FRS 2. In year 2000, there was no disclosure requirement. Therefore all disclosure of executive

directors' remuneration was voluntary. Table 2 indicates that there are large variations in the level of voluntary disclosure from a maximum voluntary score of one to none at all. The introduction of the MCCG in 2001 significantly improved the level of voluntary disclosure from the previous year ($p=0.0000$). The average voluntary score consistently improved over the years. This is supported by the Mann Whitney Wilcoxon tests on 2000 and 2008 and 2001 and 2008. However, there is a marked increase of minimum voluntary disclosure in 2007. This is consistent with the introduction of FRS 124 in 2006 that may have caused companies to voluntarily disclose more about executive directors' remuneration as they formed part of companies' 'key management personnel'. The results provide further support for hypothesis that there was an improvement in the level of voluntary disclosure of executive directors' remuneration in Malaysia.

The minimum voluntary score trends appear to stabilize after 2001. However, there is a significant decline in the level of minimum disclosure in 2008. Low disclosure companies may initially disclose more information given the emphasis on remuneration in FRS 124 but eventually disclose less as it becomes clear that FRS 124 is very broad in its disclosure requirements. It only requires mandatory disclosure of 'key management personnel' remuneration but not for individual or total executive directors.

5. Conclusions

The improvement in the level of voluntary disclosure of executive directors' remuneration after the reforms provided a positive indicator of the move to greater corporate transparency and good governance after the East Asian financial crisis. The study found that there were declining trends in the years between new disclosure requirements. Malaysian companies appear to take advantage of the broad terms of the MCCG and accounting standards and inconsistencies within the disclosure framework. They fall back to the practice of disclosing the minimum of the mandatory requirements and disclosing less voluntary information. This is contrary to the recommendations of the reforms. There is also a need to consider the impact of the traditional dominance of family and substantial shareholders in the implementations and enforcement of existing and future regulations. Under this environment, a 'hybrid' approach to regulations may need to give way to a stronger mandatory and prescriptive regulatory framework.

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