

Relative Composition of Executive Compensation Packages, Corporate Governance and Financial Reporting Quality

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Abstract : Most executive compensation packages consist of four major components: base fixed salary, annual and long-term non-equity incentive plans, share-based and option-based awards and pension value. According to agency theory, the relative composition of executive compensation packages is one of the mechanisms that firms use to align the interests of executives and shareholders in order to mitigate agency costs. This paper tests the effect of the relative composition of executive compensation packages on financial reporting quality. Financial reporting quality is measured by the value relevance of accounting earnings. Corporate governance is a moderating variable in the model. Using data from Canadian firms composing S&P/TSX index of the year 2013 and governance scores based on Board Games, the analysis shows that, only for firms with good governance, there is an optimal level of the proportion of executive equity-based compensation in relation to total compensation that enhances the quality of financial reporting.

Keywords : Canada, corporate governance, executive compensation packages, financial reporting quality

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