Journal of Accounting Review
會計評論，第67期，2018年7月
第1-40頁

高階經理人現金薪酬對重組支出與重組支出迴轉之不對稱敏感度：論薪酬委員會有效性之影響[*]

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摘要

本研究旨在檢視高階經理人現金薪酬對重組支出項目（具盈餘降低效果）與重組支出迴轉項目（具盈餘增加效果）是否具不對稱之敏感度。此外，由於高階經理人薪酬設計本身可能隱含代理問題，故進一步檢視，是否此不對稱薪酬處理會隨著薪酬委員會有效性而有所不同。本研究以美國公司為樣本，實證發現：高階經理人現金薪酬對重組支出與重組支出迴轉具不對稱之敏感度。此外發現，高度有效性薪酬委員會相對低度有效性委員會而言，其對重組支出與重組支出迴轉此二項目有較大的薪酬權數調降。整體結果隱含：公司薪酬委員會有效性較高時，較能大幅調降重組支出的薪酬權數以鼓勵具前景的重組活動，但對重組支出迴轉項目則予以濾除其對薪酬的效果，以避免管理者投機行為；薪酬委員會有效性較低的公司則仍給予重組支出迴轉項目較高的薪酬權數，偏向於利益掠奪觀點。

關鍵詞：重組支出、重組支出迴轉、高階經理人薪酬、薪酬委員會有效性

[*] 作者衷心感謝二位審查委員的意見。作者感謝科技部提供經費補助專題計畫(NSC102-2410-H-035-001-)之執行。

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收稿日：2014年11月
接受日：2018年 7月
四審後接受
主審領域主編：蔡揚宗教授
DOI: 10.6552/JOAR.201807_(67).0001

Asymmetric Sensitivity of CEO Cash Compensation to Restructuring Charges and Restructuring Charge Reversals: The Impacts of Compensation Committee Effectiveness*

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Abstract

This study examines whether CEO cash compensation is less sensitive to restructuring charges than to the reversals of restructuring charges, i.e., an asymmetric treatment for restructuring charges and the related reversals. In addition, given that executive compensation design itself may be an agency problem, we also examine whether this asymmetric treatment varies with compensation committee effectiveness. Using a US sample of firm-year observations, this study finds that there is an asymmetric compensation sensitivity to restructuring charges and restructuring charge reversals. Furthermore, we find that highly effective compensation committees reduce the compensation weight more on restructuring charges and restructuring charge reversals compared to compensation committees characterized by low effectiveness. The overall results imply that firms with highly effective compensation committees encourage prospective restructuring activities by shielding executive compensation from the effect of restructuring charges, and filter restructuring charge reversals from CEO compensation to avoid opportunistic behavior of rent extraction. However, restructuring charge reversals are rewarded by committees characterized by low effectiveness through the placement of a higher compensation weight, which is consistent with the view of managerial rent extraction.

Keywords: *Restructuring charges, Restructuring charge reversals, CEO compensation, Compensation committee effectiveness.*

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* The authors acknowledge the helpful comments of two anonymous reviewers. The authors acknowledge the financial support from the Ministry of Science and Technology (NSC102-2410-H-035-001-).

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Submitted November 2014
Accepted July 2018
After 4 rounds of review
Field Editor: Professor Yong-Tzong Tsay
DOI: 10.6552/JOAR.201807_(67).0001

1. INTRODUCTION

There has been considerable work examining different aspects of corporate restructuring, including investors' responses/valuation, post-operating performance, related earnings management, and the impact on executives' compensation. However, the reversal of restructuring charges has been less directly examined apart from the earnings management issue. Restructuring activity is usually regarded as having a positive implication for firm value and thus managerial compensation is shielded from income-decreasing effects of related charges (Dechow, Huson, and Sloan 1994). Several studies have provided evidence on how the frequency of reported restructuring charges (Dechow et al. 1994; Adut, Cready, and Lopez 2003; Balsam, Reitenga, and Sanchez 2007) and the components of restructuring expenditures (Dorata 2008) influence compensation shielding decisions. Nevertheless, the aspect of restructuring charge reversals seems to be neglected in this stream of the literature. The current study thus extends this line of research by taking the reversal of restructuring charges into account. Specifically, we aim to examine the existence of an asymmetric compensation sensitivity to restructuring charges and the reversal of restructuring charges, both of which result in income-decreasing and income-increasing effects, respectively.

Built on Gaver and Gaver's (1998) evidence on the existence of differential compensation treatments for aggregated losses vs. gains and for positive earnings vs. negative earnings, this study investigates a specific non-recurrent, while significant, corporate event-"corporate restructuring". Managerial compensation is found to be at least partially shielded from the income-decreasing effect of corporate value-created restructuring (e.g., Dechow et al. 1994). Nevertheless, this compensation shielding behavior may lead to an asymmetric compensation treatment for the charges and reversals of restructuring activities, when the reversals are not filtered from the compensation in the same manner. Such asymmetric compensation sensitivity will result in a greater level of managerial compensation. Given considerable public concern over excess managerial compensation in recent years, the first purpose of this study is to examine whether there exists asymmetric sensitivity of executive compensation to restructuring charges and the reversal of restructuring charges.

Based on prior research (Gaver and Gaver 1998), the asymmetric compensation sensitivity to restructuring charges and the related reversals may result from optimal contracting or from the managerial entrenchment, or both. The three-tier agency theory (Antle 1982; Kofman and Lawarrée 1993) indicates that whether the compensation committee will work in the best interests of shareholders or instead collude with top managers is dependent on whether the committee's interests are more tightly related to

those of shareholders (principal) or managers (agent). Although the compensation committee under the optimal contracting perspective should work in shareholders' interests to provide a cost-effective incentive plan to managers, prior empirical studies (e.g., Conyon and He 2004) find that the effectiveness of this committee will influence the quality of executive compensation design. Specifically, higher quality compensation committees are capable of designing and implementing remuneration arrangements that will lead to stronger incentives for subsequent performance and reduce the capacity of CEOs to extract rents (Sun, Cahan, and Emanuel 2009). In addition, Bebchuk and Fried (2003) propose the managerial power perspective, indicating that powerful managers may engage in influencing the compensation committee to design compensation in their favor, while at the expense of shareholders' interests. Therefore, the greater the managerial power, the less the effectiveness of the compensation committee and in turn the less the quality of executive compensation design. This study accordingly introduces the factors associated with committee member characteristics and CEO power to examine the impact of compensation committee effectiveness.

In terms of restructuring charges and the reversals, the compensation may be designed as adjusting downward the compensation weight on restructuring charges, while not doing so proportionally (in the same manner) on reversals. This asymmetric treatment may be used, on the one hand, to motivate executives' value-enhancing restructuring activities, but, on the other hand, to extract excess executive compensation by powerful self-serving managers. Therefore, given that the greater asymmetric compensation treatment suffers from a higher possibility of managerial entrenchment, the second purpose of this study is to examine whether the effectiveness of compensation committees, diminished by managerial power, asymmetrically adjust the sensitivity of executive compensation to both restructuring charges and the related reversals.

Using a US sample of firm-year observations drawn from fiscal years 1998 to 2011, our empirical results suggest that the sensitivity of CEO pay to restructuring charges is lower than the sensitivity to restructuring charge reversals, supporting the prediction of an asymmetric compensation treatment induced by contracting efficiency or managerial entrenchment. In addition, we find the compensation weight on restructuring charges of firms with highly effective compensation committees is less than that of firms with compensation committees characterized by low effectiveness. Finally, an additional analysis shows that the compensation sensitivity to reversals with suspicion of manipulating earnings is also reduced for firms with highly effective compensation committees.

This study contributes to the existing literature on restructuring activities, CEO compensation and compensation committee effectiveness, and thereby provides policy-

and practice-related implications. First, restructuring activity is a significant corporate transaction with two aspects of accounting recognition, restructuring charges and related reversals. The compensation adjustment in this series of research (e.g., Dechow et al. 1994) focuses primarily on restructuring charges. Responding to the call (e.g., Dechow et al. 1994) for additional research on the accounting gain that may have a much different scenario, we take restructuring charge reversals into account. This study, therefore, complements prior research by shedding light on the potential for managerial rent extraction through asymmetrically treating restructuring charges and restructuring charge reversal in the compensation function. Next, our evidence based on a US sample suggests that the CEO compensation design for specific earnings components varies with compensation committee effectiveness. Specifically, compensation committee effectiveness is found to help the committees look beyond the restructuring related earnings components in setting executive compensation. Thus, an important implication of this study is that, given the complicated information nature of some earnings components such as restructuring charges, the establishment of an effective compensation committee is essential to improving contracting efficiency. In turn, this US-based finding has an implication for policymakers in emerging markets such as Taiwan. Following the developed countries, Taiwan's publicly held firms have been required to establish compensation committees since 2011, while only a few restrictions are imposed on the qualification of committee members. Given this, it is necessary for the relevant governance authorities to evaluate the performance of compensation committees and then continuously engage in strengthening compensation committee governance. Finally, our evidence also implies that shareholders and directors have to concern about the effectiveness of compensation committees because such committees may affect the effectiveness of a compensation design and in turn ensure the protection of shareholders' interests.

The remainder of the study is organized as follows. Section 2 presents the background, literature review, and hypothesis development. Section 3 describes the research design. Section 4 describes the empirical results, and Section 5 presents the conclusions of this paper.

2. BACKGROUND, LITERATURE AND HYPOTHESES

2.1 The Background of the Accounting for Restructuring Activities

Corporate restructuring might be driven by different objectives associated with the creation of firms' long-term profits. Firms may incur restructuring charges to improve current operating efficiency, to help firms recover from financial distress, or to expand operations, e.g., stepping up production or diversifying into new markets. A restructuring activity typically involves the modification of firm strategies, the termination of personnel,

the elimination of unprofitable business lines, and the disposal of assets (Daniels, Rouse, and Weirich 1995).

Prior to 1994, there was no accounting guidance for restructurings. In 1994, the Emerging Issues Task Force (EITF) released no. 94-3, "*Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)",* which stated that restructuring charges could be accrued only if a commitment to a restructuring plan existed, and the related costs have no future economic benefits to the firm. Under the EITF 94-3, the firms must disclose the amounts and nature of the material components of a restructuring charge.

In 2002, the Financial Accounting Standards Board (FASB) released the SFAS 146 "*Accounting for Costs Associated with Exit or Disposal Activities*", which affects the accounting for restructuring charges. The provisions are effective for exit or disposal activities initiated after December 31, 2002. The primary difference between EITF 94-3 and SFAS 146 is that prior to SFAS 146, restructuring costs were booked as a liability at the date of a commitment to a restructuring plan. SFAS 146 requires companies to recognize costs associated with exit or disposal activities at the time they are incurred[1]. SFAS 146 applies to restructuring costs that include employee termination benefits, costs to terminate a contract that is not a capital lease, and costs to consolidate facilities or relocate employees. Although some corporate restructurings include the retirement of long-lived assets and a business combination, these costs are governed by other accounting standards[2].

SFAS 146 requires companies to reverse restructuring charges when a circumstance occurs that discharges an entity's responsibility to settle a liability for a cost associated with an exit or disposal activity recognized in a prior period. The related costs should be reversed through the same line item(s) in the income statement used when those costs were recognized initially.

2.2 Empirical Research on Restructuring Activities: The Motivations and Effects

It is generally believed that corporate restructuring activities are driven to enhance firm performance/value, while the real motivation and the resulting consequences are still open issues. There has been considerable work examining the economic implication of corporate restructuring from different aspects, including investors' responses/valuation, post-operating performance, the potential earnings management incentive, and the impact on executives' compensation.

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[1] This statement specifies that a liability for a cost associated with an exit or disposal activity is incurred when the definition of a liability in FASB Concepts Statement 6 is met.

[2] SFAS 146 applies to costs associated with an exit activity that does not involve an entity newly acquired in a business combination or with a disposal activity covered by SFAS 144.

A variety of direct or indirect research findings provide insights into the motivations and effects of restructuring activities. The direct examination of post-restructuring performance shows little support for the association between restructuring charges and subsequent improved performance. Atiase, Platt, and Tse (2004) find a positive association between restructuring charges and post-restructuring performance, in terms of earnings and operating cash flows only for repeatedly restructuring firms and loss firms. This is consistent with the finding of Denis and Kruse (2000) that corporate restructurings are responses to extreme poor performance.

From the perspective of outside investors, many studies examine the stock returns consequence of restructuring charges and in turn infer the implication underlying the market effect. Some studies find that the market reacts positively to restructuring charge announcements because corporate restructuring may be a signal of future investment opportunities and improvements in efficiency (Brickley and Drunen 1990; John and Ofek 1995; Francis, Hanna, and Vincent 1996; Bunsis 1997; Kross, Park, and Ro 1998; Ballester, Livnat, and Sinha 1999; Denis and Kruse 2000; Chalos and Chen 2002; Kross, Ro, and Suk 2011). However, several studies show the results of negative market reactions, which indicates that restructurings are often the company's responses to significant operational problems and are thus viewed by the market as bad news (Blackwell, Marr, and Spivey 1990; Elliott and Hanna 1996; Carter 2000; Poon, Newbould, and Durtschi 2001; Bens 2002; Holder-Webb, Lopez, and Regier 2005). By further classifying restructuring firms as different groups, Khurana and Lippincott (2000) show that restructuring charges are positively associated with raw stock returns of loss firms, but not of profit firms. They argue that investors probably consider restructuring activities by loss firms as value creating, but not those by profit firms. Similarly, given that investors will consider details in the restructuring plan to expect firms' future performance, Jaggi, Lin, Govindaraj, and Lee (2009) find that investors react positively to restructuring that is expected to be successful in improving firm performance but react negatively to unsuccessful firms when the magnitude of restructuring charges is high. From the above discussion, we can conclude that investors' reaction to restructuring charges would depend upon their assessment of whether restructuring can improve a firm's future operating performance.

In addition to the economic explanation, the prior literature also finds that special charges, including restructurings, serve as a tool to manage earnings. For example, Moehrle (2002) finds that managers are more likely to record reversals when pre-reversal earnings are below analysts' forecasts, when the firm experiences a pre-reversal loss, and when pre-reversal earnings are below prior-year levels. This evidence reveals that firms use restructuring accrual reversals to beat analysts' forecasts and to avoid net losses. In addition, Bens and Johnston (2009) find the timing and magnitude of reversals are related to earnings benchmarks, supporting the notion that these potentially discretionary reversals

reflect managers' earnings management behavior. Collectively, the recognition of restructuring charge reversals is documented as a potential form of earnings management, which is one type of agency problem. This study examines another agency problem related to the compensation side effects of restructuring charge reversals.

2.3 Hypotheses Development

2.3.1 Asymmetric sensitivity of CEO compensation to restructuring charges versus restructuring charge reversals

An optimal contract is designed to maximize the net expected economic value to shareholders after transaction costs (e.g., contracting costs) and payments to employees (Core, Guay, and Larcker 2003). Based on this viewpoint, prior studies provide evidence that compensation committees adjust earnings-based compensation measures to counteract potentially opportunistic behavior and to provide proper incentives for managers to engage in value-enhancing behavior (Comprix and Muller 2006). Specifically, by adjusting compensation weights on some earnings components, they shield CEO compensation from the income-decreasing effects of some charges that may contribute to firms' long-term value. These specific earnings components include restructuring charges (Dechow et al. 1994; Adut et al. 2003; Balsam et al. 2007), R&D and advertising expenditures (Duru, Iyengar, and Thevaranjan 2002; Cheng 2004; Cao and Laksmana 2010), and information technology expenditures (Masli, Richardson, Sanchez, and Smith 2014).

As to restructuring charges of interest in this study, Dechow et al. (1994) is the first study to examine whether the compensation committees shield CEO cash compensation from restructuring charges that have a material impact on reported income. Their results show that compensation committees' shielding behavior to be of a smaller degree if the firm is a frequent restructurer but of a greater degree if the CEO has longer tenure. In addition, Adut et al. (2003) find that compensation committees partially shield CEO compensation from restructuring charges. They find that compensation committees completely shield initial and subsequent restructuring charges taken by long-tenured CEOs. Given that Dechow et al. (1994) call for future research to document the full scope of intervention by the committee, we take the reversal of restructuring charges into account and examine the existence of the asymmetric compensation sensitivity to restructuring charges and the reversal of restructuring charges. We thus develop our hypotheses based on prior literature on the asymmetric treatment for losses and gains in executive compensation (e.g., Gaver and Gaver 1998; Balsam 1998; Comprix and Muller 2006; Zhang and Cahan 2010; Manchiraju, Hamlen, Kross, and Suk 2016; Chen and Tang 2017).

Gaver and Gaver (1998) test for differential weights on positive and negative earnings and on nonrecurring losses and gains in the compensation function. They find that cash compensation is significantly positively related to above the line earnings if results are

positive, but not if they are negative. They also find that the compensation committees do not place the compensation weights in a symmetric manner for similar types of gains and losses. This asymmetric compensation treatment can be explained by the optimal contracting and/or managerial entrenchment views. The former indicates that the committee may wish to avoid penalizing managers for value-enhancing activities that result in current period losses. Nevertheless, the latter suggests that the asymmetric compensation treatment, resulting in excess executive compensation, may arise from managers' self- interests.

Similar to Gaver and Gaver (1998), Zhang and Cahan (2010) examine the effect of nonrecurring accounting transactions on stock option grants and provide evidence of asymmetric stock-option treatment for nonrecurring gains and losses. They further examine and find that this compensation adjustment is associated with firms' high growth opportunities and weak corporate governance. The association of firm growth with asymmetric compensation treatment reflects the purpose of reducing managerial risk aversion and thus supports the contracting efficiency view. However, the association with weak corporate governance implies a poor compensation design quality and thus supports the managerial power perspective. Other empirical evidence on the asymmetric compensation treatment includes the following. Balsam (1998) finds that compensation committees assign greater weights to positive discretionary accruals than to negative discretionary accruals in determining CEOs' cash compensation. Comprix and Muller (2006) find that CEO cash compensation is more sensitive to reported pension income than to pension expense.

More recently, Manchiraju et al. (2016) examine the sensitivity of CEO compensation to fair value gains and losses in derivatives for firms in the U.S. oil and gas industry. They find that CEOs are rewarded for hedge and non-hedge derivative gains, and the CEO compensation is more sensitive to non-hedge derivative gains than it is to non-hedge derivative losses. Because these two types of derivatives have different implications for firm risk and value, their results imply that boards are not discouraging CEOs from using risk-increasing non-hedge derivatives. In addition, Chen and Tang (2017) examine how compensation committees react to a new income item called revaluation gains and losses (RGL) mandated by IFRS. They find that compensation is sensitive to revaluation gains, but not to revaluation losses, suggesting that compensation committees shield CEO compensation from the decline in the fair value of investment properties.

In the cases of restructuring charges (income-decreasing effect) and the reversal of restructuring charges (income-increasing effect), it is unclear whether there is an asymmetric compensation adjustment for these two components. Here, we predict the potential differential treatment for restructuring charges and reversals from the

perspectives of contracting efficiency and/or managerial entrenchment.

Under optimal contracting efficiency, the compensation weights on the restructuring charges are lowered, thereby shielding executive compensation from the adverse effect of these charges. This shielding aims to reduce managerial risk-taking and encourage their long-run perspective actions. As to the related reversals of restructuring charges, compensation committees may remain the same compensation weights on reversals to ensure executive compensation not to be reduced. This could be seen as a rational response to competitive conditions in the managerial labor market if it increases the firm's ability to attract and retain top management talent.

Under the managerial power perspective (Bebchuk, Fried, and Walker 2002), powerful managers have the ability and incentive to exercise their influence over the compensation committee, thereby making compensation design favorable to themselves at the expense of outside shareholders. Therefore, in terms of specific earnings elements such as restructuring charges and related reversals, ineffective compensation committees that are influenced by powerful managers may only reduce the compensation weights on the restructuring charges (income-decreasing components), while maintaining the same weights on the reversals (income-increasing components) to avoid a reduction in executive compensation. This is particularly the case when the reversal of restructuring charges is likely related to earnings management, which is conducted by self-interested managers (Moehrle 2002).

According to the above discussions, it is expected that the compensation weights on restructuring related charges are lowered but those on reversals are not. That is, we hypothesize the existence of the asymmetric compensation treatment for restructuring charges and the reversals of restructuring charges. The first hypothesis is stated as follows (in an alternate form):

H1: CEO cash compensation is less sensitive to restructuring charges than to the reversals of restructuring charges.

2.3.2 The role of compensation committee effectiveness in designing executive compensation

Many critics of CEO compensation practices have argued that the designer of CEO compensation (the board of directors or the compensation committee) is influenced by the CEO. In this situation, CEO compensation is designed in CEOs' favor and then contradicts with the aim of maximizing shareholders' value. As the three-tier agency theory (Antle 1982; Kofman and Lawarrée 1993) suggests, shareholders (the principal) delegate monitoring authority to a separate supervisor (e.g., compensation committee), who evaluates the agent (e.g., CEO). Under this structure, whether the compensation committee

will design executive compensation in the shareholders' best interests is dependent on the effectiveness of compensation committees. The committees' effectiveness is affected by characteristics associated with their monitoring incentive and ability (e.g., Sun and Cahan 2012). Furthermore, Bebchuk and Fried (2003) propose that CEO compensation design itself is subject to an agency problem. Specifically, they suggest that powerful CEOs have substantial influence over the compensation committee to extract the rents. This implies that the effectiveness of compensation committees is affected not only by their characteristics but also by managerial power.

Prior research provides evidence supporting the notion that great managerial power and weak corporate governance relate to several attributes associated with poor compensation designs. These poor designs include: (1) pay for luck (Bertrand and Mullainathan 2001), (2) higher level of executive compensation (e.g., Yermack 1997; Core Holthausen, and Larker 1999; Conyon and He 2004; Choe, Gloria, and Yin 2009; Chen, Liu, and Li 2010), (3) higher compensation weights on accounting performance measures relative to on market-based measures (e.g., Davila and Penalva 2006[3]), (4) lower disclosure level of executive compensation (Kalyta 2009), (5) less (higher) proportion of options grant (bonus) in the compensation package (Grinstein and Hribar 2004; Ferris, Kim, Kitsabunnarat, and Nishikawa 2007; Sun et al. 2009; Henderson, Masli, Richardson, and Sanchez 2010), and (7) an asymmetric compensation treatment for gains and losses (Zhang and Cahan 2010; Manchiraju et al. 2016; Chen and Tang 2017). More specifically, the asymmetric compensation sensitivity to gains and losses for firms with relative weak corporate governance structure is documented for the following components: nonrecurring gains vs. nonrecurring losses (Zhang and Cahan 2010), non-hedge derivative gains vs. non-hedge derivative losses (Manchiraju et al. 2016), and revaluation gains vs. revaluation losses (Chen and Tang 2017). By contrast, high-quality compensation committees design CEO compensation that will provide managers with stronger incentives for future performance and reduce the ability of CEOs to extract rents (Sun et al. 2009). Similarly, Vafeas (2003) indicates that directors with more valuable reputation capital are less likely to collude with management in setting compensation and are therefore better monitors because their own human capital is at stake. Moreover, the extent to which the board adjusts reported earnings numbers in determining CEO compensation for shareholders' interests depends on the accounting knowledge of the board (Manchiraju et al. 2016). All of the above empirical evidence indicates that as a compensation committee's effectiveness increases, the compensation arrangements are likely to be designed in a direction favorable

[3] Davila and Penalva (2006) find that compensation contracts in firms with higher takeover protection and where the CEO has more influence on governance decisions put more weight on accounting-based measures of performance (return on assets) compared to stock-based performance measures (market returns). This is because accounting-based measures are more controllable and thus reduce variability in actual compensation.

to shareholders by serving as a control device against managers, as predicted by the agency theory.

In terms of restructuring charges and the related reversals, an increasingly asymmetric treatment for restructuring charges and the related reversals may suffer from managerial rent extraction. According to the above literature review and discussions, effective compensation committees have an incentive and ability to mitigate managerial rent extraction and may thus reduce the compensation weight on the reversals (an income-increasing component) to a certain degree, even to be zero or negative. This is especially the case for those restructuring reversals suspected to be used to manage earnings (Moehrle 2002). By contrast, given the long-run prospects of restructuring charges, the shielding of executive compensation from restructuring charges has been evidenced in a series of studies. Nevertheless, in the presence of powerful managers, it is not clear whether their compensation is overly shielded from restructuring charges. Therefore, an effective compensation committee may increase or decrease the shielding degree based on their expectations for the prospects of restructuring activities. We accordingly expect a significant association between the compensation committee effectiveness and the compensation adjustment for restructuring charges. Taken together, it is expected that compensation committees with high or low effectiveness have differential treatments for the compensation sensitivities of restructuring charges and restructuring charge reversals, as discussed above. The corresponding hypotheses two and three are formulated as below:

H2: For restructuring charges, firms' compensation committee effectiveness is significantly associated with the compensation sensitivity to restructuring charges.

H3: For the restructuring charge reversals, firms with highly effective compensation committees place a lower compensation weight than firms with compensation committees characterized by low effectiveness.

3. RESEARCH DESIGN

3.1 Regression Models and Variable Definitions

3.1.1 Test of hypothesis 1

Hypothesis 1 states that CEO cash compensation is less related to restructuring charges than to restructuring charge reversals. Following the prior literature, we modify the equation of Adut et al. (2003) to form our base model as follows:

$$COMP_{i,t} = \alpha_0 + \alpha_1 ADJ\_EARN_{i,t} + \alpha_2 RCA\_INC_{i,t} + \alpha_3 RRA\_INC_{i,t} + \alpha_4 HI\_CCMQ_{i,t} + \alpha_5 RET_{i,t} + \alpha_6 RISK_{i,t} + \alpha_7 MB_{i,t} + \alpha_8 LEV_{i,t} + \alpha_9 SIZE_{i,t} + \sum_{j=1998}^{2010} \lambda_j YEAR_j + \sum_{k=1}^{41} \gamma_k IND_k + \varepsilon_{i,t}. \quad (1)$$

The definitions of variables are described as follows:

CEO Compensation ($COMP_{i,t}$) is defined as the log of CEO cash compensation (*CASH_COMP*) for firm i in year t, which is the natural log of CEO salary plus bonus. This paper uses logarithmic transformation to control for skewness in executive annual pay (Sloan 1993). $ADJ\_EARN_{i,t}$ is defined as earnings before restructuring charges and restructuring charge reversals for firm i in year t, scaled by the average book value of common equity. $RCA\_INC_{i,t}$ is the amount of restructuring charges for firm i in year t divided by the average book value of common equity. $RRA\_INC_{i,t}$ is the amount of restructuring charge reversals for firm i in year t divided by the average book value of common equity.

To measure the effectiveness of the compensation committee, we follow prior studies to consider seven variables that proxy for related characteristics affecting the compensation committee quality: $DUALITY_{i,t}$, $TENURE_{i,t}$, $APPOINT_{i,t}$, $CMSIZE_{i,t}$, $SHARES_{i,t}$, $FINEXPERT_{i,t}$, and $SENIOR_{i,t}$. The following are their definitions:

(1) $DUALITY_{i,t}$ is an indicator variable, coded as one if the CEO serves as the chairman of the board for firm i in year t and zero otherwise (Fama and Jensen 1983; Goyal and Park 2002). The CEO serving as the chairman of the board may increase his or her power. Given this, firm decisions may act to serve the self-interests of the CEO rather than the interests of shareholders due to the CEO's extraordinary influence over board decisions (Core et al. 1999). Thus, the presence of a chairman who is also the chief executive of a company could weaken the effectiveness of the board of directors (Jensen 1993), thereby weakening the compensation committee's effectiveness.

(2) $TENURE_{i,t}$ is operationalized as the number of years the executive has been CEO for firm i in year t (Finkelstein and Hambrick 1989). Managerial power can increase when CEOs stay longer in their position (Zheng 2010). In addition, the likelihood that a CEO has control over the internal monitoring mechanisms increases with his tenure as CEO. Therefore, as evidenced in Ryan, Wang, and Wiggins (2009), CEO tenure decreases board monitoring. Accordingly, we expect that CEO tenure would reduce the monitoring ability of the compensation committee.

(3) $APPOINT_{i,t}$ is defined as the proportion of CEO appointed directors on the compensation committee for firm i in year t. The prior literature indicates that if the directors are appointed during the tenure of the CEO, the compensation committees are likely to have a more amiable relationship with the CEO (e.g., Wade, O'Reilly, and

Chandratat 1990; Larcker, Richardson, and Tuna 2007). Bebchuk and Fried (2004) also indicate that CEO appointed directors are likely to have an interdependent relationship with the CEO. Thus, we expect the compensation committee with more CEO appointed directors would have a lower monitoring ability.

(4) $CMSIZE_{i,t}$ is the number of directors on the committee for firm i in year t. Bushman, Chen, Engel, and Smith (2004) argue that larger boards have the advantage of more advisors and monitors of management. Furthermore, in designing executive compensation, it may be more difficult for CEOs, even with great power, to exert as much influence over a larger committee. Thus, we expect that a compensation committee is more effective when the number of directors on the committee (*CMSIZE*) is higher.

(5) $SHARES_{i,t}$ is the aggregate directors' shareholdings for firm i in year t. Shivdasani and Yermack (1999) indicate that directors with high ownership should have interests more aligned with shareholders and may have stronger incentives to monitor the CEO. Thus, we use the aggregate directors' shareholdings (*SHARE*) to measure compensation committee effectiveness.

(6) $FINEXPERT_{i,t}$ is a dummy variable coded one if a financial expert sits on the compensation committee for firm i in year t, zero otherwise. According to the prior literature, we consider directors with backgrounds in finance to be financial experts (DeFond, Hann, and Hu 2005). If the directors are financial experts (*FINEXPERT*), we expect that they have more ability to see through the recognition of restructuring charges and restructuring charge reversals.

(7) $SENIOR_{i,t}$ is the proportion of directors on the committee with 10 or more years of board service for firm i in year t. The prior literature indicates that directors with long tenure are more effective because of their greater experience (Vafeas 2003) and have greater firm-specific reputational capital at stake (Fama and Jensen 1983). Thus, we use the proportion of directors on the committee with 10 or more years of board service time (*SENIOR*) as one component of compensation committee effectiveness.

These seven measures are converted to the percentile scores, after which this study constructs an index, $CCMQ_{i,t}$, to capture the combined effect of these factors[4]. $CCMQ_{i,t}$ equals the average of these seven percentile values for firm i in year t. The indicator variable of high compensation committee effectiveness ($HI\_CCMQ_{i,t}$) equals one if the compensation committee effectiveness score ($CCMQ_{i,t}$) of the firm is above the median score for the sample for firm i in year t, and zero otherwise.

[4] Sun and Cahan (2012) indicate that firms with lower CEO influence are more likely to have high quality compensation committees. Thus, *DUALITY*, *TENURE* and *CEOAPP* are multiplied by -1 and then converted to the percentile scores as components of compensation committee effectiveness.

As for the prediction for the coefficient of *HI_CCMQ,* the inference is as follows. Compensation committees are delegated to set and structure optimal pay packages to provide the right incentives for managers to operate in shareholders' interests. The optimal CEO compensation structure depends on the tradeoff between managerial agency problems and risk-shifting problems (John and John 1993). Given the various problems faced by different CEOs, effective compensation committees have to allocate differential components of compensation for them based on firms' and CEOs' characteristics. Accordingly, the direction of the relationship between CEO cash compensation and the indicator variable of the high-effectiveness compensation committee is not predicted.

Following prior research, we also consider additional control variables. In addition to accounting-based performance, market-based performance (e.g., stock performance) affects CEO compensation to a certain degree. We thus include stock returns ($RET_{i,t}$) as a control to measure stock performance. $RET_{i,t}$ is calculated as a firm's cumulative monthly raw returns for the fiscal year for firm i in year t and is expected to be positively associated with CEO compensation (Hanlon, Rajgopal, and Shevlin 2003; Leone, Wu, and Zimmerman 2006; O'Connell 2006; Carter, Lynch, and Tuna 2007; Sun and Cahan 2009; Shaw and Zhang 2010; Ferri and Maber 2013). $RISK_{i,t}$, defined as firm risk, is measured by the volatility of monthly stock returns for firm i in year t (Core et al. 1999; Livne, Markarian, and Milne 2011). Because prior studies provide conflicting arguments about the relation between risk and CEO compensation (Gray and Cannella 1997; Bloom and Milkovich 1998), this study does not predict the sign on firm risk. $MB_{i,t}$ is firms' growth opportunities, measured as the market value of equity over the book value of equity for firm i in year t (Livne et al. 2011; Masli et al. 2014; Manchiraju et al. 2016). The coefficient of *MB* is expected to be positive because it is documented that a firm's growth opportunities have a positive impact on its executive compensation policy (Himmelberg, Hubbard, and Palia 1999; Harjoto and Mullineaux 2003). $LEV_{i,t}$ is the proxy of a firm's leverage, which is defined as total liabilities divided by assets for firm i in year t (Livne et al. 2011). The prior literature indicates that highly leveraged firms have incentives to decrease the intensity of incentives provided by stock-based awards and shift the mix of CEO pay toward cash compensation (John and John 1993; Yermack 1995). Therefore, we expect a firm's leverage to be positively associated with CEO cash compensation. $SIZE_{i,t}$, measured as the log of total assets for firm i in year t, captures firm size (Baker, Jensen, and Murphy 1988; Rosen 1992; Hartzell and Starks 2003; Geiger and Cashen 2007; Tsai, Kuo, and Hung 2009) and is expected to have a positive coefficient because of the demand for higher-quality managerial talent (Finkelstein and Hambrick 1989; Lambert, Larcker, and Verrecchia 1991; Gomez-Mejia 1994; Tosi, Werner, Katz, and Gomez-Mejia 2000). Finally, given the potential differences in executive compensation level across years and industries, we follow prior studies to control for both industry-fixed and year-fixed effects

in the pooled model by including year and industry dummies (Cheng and Farber 2008; Banker, Darrough, Huang, and Plehn-Dujowich 2013; Hui and Matsunaga 2015)[5].

In testing hypothesis one, this study examines the relative magnitude of two coefficients: α_2 and α_3. α_2 is the coefficient of the restructuring charge (*RCA_INC*) and α_3 is the coefficient of the restructuring charge reversals (*RRA_INC*). Based on the expectation of H1, α_2 is expected to be lower than α_3, which reflects the asymmetric sensitivity of CEO cash compensation to restructuring charges and restructuring charge reversals.

3.1.2 Test of hypotheses 2 and 3

To test H2 and H3, we modify model (1) by including two interaction terms, $HI\_CCMQ \times RCA\_INC$ and $HI\_CCMQ \times RRA\_INC$, and then model (2) is shown as below.

$$\begin{aligned} COMP_{i,t} = {} & \beta_0 + \beta_1 ADJ\_EARN_{i,t} + \beta_2 RCA\_INC_{i,t} + \beta_3 RRA\_INC_{i,t} \\ & + \beta_4 HI\_CCMQ_{i,t} + \beta_5 HI\_CCMQ \times RCA\_INC_{i,t} \\ & + \beta_6 HI\_CCMQ \times RRA\_INC_{i,t} + \beta_7 RET_{i,t} + \beta_8 RISK_{i,t} \\ & + \beta_9 MB_{i,t} + \beta_{10} LEV_{i,t} + \beta_{11} SIZE_{i,t} + \sum_{j=1998}^{2010} \varphi_j YEAR_j + \sum_{k=1}^{41} \theta_k IND_k + \varepsilon_{i,t}. \end{aligned} \quad (2)$$

The coefficients of interest in the second and third hypotheses are those reflecting the differential effects across highly effective compensation committees and those characterized by low effectiveness. Specifically, the coefficient of $HI\_CCMQ \times RCA\_INC$, β_5, represents the differential treatment for the compensation sensitivity to restructuring charges across highly effective compensation committees and those with low effectiveness. Similarly, the coefficient of $HI\_CCMQ \times RRA\_INC$, β_6, represents the differential effects on the compensation sensitivity to restructuring charge reversals across highly effective compensation committees and those with low effectiveness. Based on the predictions of H2 and H3, β_5 are expected to be significantly different from zero and β_6 are expected to be significantly negative, respectively.

For firms with lower compensation committee effectiveness, their compensation weights on restructuring charges and the reversals are reflected in β_2 and β_3, respectively. For firms with higher compensation committee effectiveness, the incremental effects of highly effective firms reflect in β_5 and β_6. Thus, (β_2 +β_5) and (β_3 +β_6) represent firms' compensation weights on restructuring charges and reversals of restructuring charges, respectively, for firms with highly effective compensation committees.

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[5] We define industries based on Fama and French's (1997) 48 industry classifications, which have been widely used in the prior literature (e.g., Bebchuk and Grinstein 2005; Ciftci, Lev, and Radhakrishnan 2011; Lehavy, Li, and Merkley 2011; Sridharan 2015; Hong, Li, and Minor 2016).

3.2 Sample Selection and Data Sources

This paper collects all the data associated with executive compensation, financial information, the measures for compensation committee effectiveness, and stock returns from ExecuComp, Compustat, RiskMetrics, and CRSP. The research period spans from 1998 to 2011. For firm-year observations that have restructuring charges data but have missing restructuring charge reversals, *RRA_INC* is set to 0. The following restrictions on the sample are imposed: (1) this paper eliminates observations whose primary businesses are financial services and utility based on the prior literature (e.g., Huson, Yao, Wiedman, and Wier 2012); (2) we delete observations if the CEO was not in office for the entire current and previous year; (3) we delete observations with missing and incomplete data; (4) to mitigate the influence of extreme observations, this paper filters each financial variable at the 1st and 99th percentiles[6]. This sample selection procedure, outlined in Table 1, results in the final sample composed of 3,366 firm-year observations.

Table 1 Selection of the Sample

		Number of firms
Companies that report restructuring charges information in ExecuComp from 1998 to 2011		6,392
Less firms:		
whose primary businesses are financial services and utility	(569)	
if the CEO was not in office for the entire current and previous year	(653)	
observations that could not be matched with CRSP	(868)	
observations with insufficient Riskmetrics data	(654)	
Outliers (filters each financial variable at the 1st and 99th percentiles)	(282)	(3,026)
Observations in final sample		3,366

3.3 Sample Distribution by Year and Industry

Table 2 displays descriptive statistics for sample distribution by year and industry. Panel A of Table 2 reports that the number of restructuring charges ranges from a low of 2 in 1998 to a high of 417 in 2009. This distribution reflects an increase in the number of observations over time in the sample period and reveals that approximately 45% of observations occur in the last four years. Panel B of Table 2 presents the industry distribution of our sample. The highest frequency of firms occurs in business services (12.3%), followed by electronic equipment (10.78%), machinery (7.43%), chemicals (5.11%) and computers (4.84%). Although these five industries account for 40% of the sample, Table 2 also shows that our sample firms are from a broad spectrum of industries. Given these distribution patterns, we control for both industry- and year-fixed effects in all regression models.

[6] We also exclude observations whose adjusted earnings is negative, and the results are qualitatively the same.

Table 2 Sample Distribution by Year and Industry

Panel A: Sample Distribution by Year		
Year	Number	Percentage
1998	2	0.06%
1999	6	0.18%
2000	16	0.48%
2001	261	7.75%
2002	238	7.07%
2003	239	7.10%
2004	251	7.46%
2005	253	7.52%
2006	287	8.53%
2007	285	8.47%
2008	369	10.96%
2009	417	12.39%
2010	374	11.11%
2011	368	10.93%
Total	3,366	100.00%
Panel B: Sample Distribution by Industry		
Fama and French (1997) 48 industry classifications	Number	Percentage
1 Agriculture	14	0.42%
2 Food products	125	3.71%
3 Candy & soda	14	0.42%
4 Beer & liquor	34	1.01%
5 Tobacco products	14	0.42%
6 Recreation	23	0.68%
7 Entertainment	8	0.24%
8 Printing and publishing	56	1.66%
9 Consumer goods	109	3.24%
10 Apparel	63	1.87%
11 Healthcare	36	1.07%
12 Medical equipment	136	4.04%
13 Pharmaceutical products	147	4.37%
14 Chemicals	172	5.11%
15 Rubber and plastic products	42	1.25%
16 Textiles	16	0.48%
17 Construction materials	86	2.55%
18 Construction	20	0.59%
19 Steel works, etc.	62	1.84%
20 Fabricated products	2	0.06%
21 Machinery	250	7.43%
22 Electrical equipment	105	3.12%
23 Automobiles and trucks	43	1.28%
24 Aircraft	46	1.37%
25 Shipbuilding, railroad equipment	3	0.09%
26 Defense	10	0.30%
27 Precious metals	1	0.03%
28 Nonmetallic and industrial metal mining	7	0.21%
29 Coal	2	0.06%
30 Petroleum and natural gas	70	2.08%
32 Communication	66	1.96%
33 Personal services	13	0.39%
34 Business services	414	12.30%
35 Computers	163	4.84%
36 Electronic equipment	363	10.78%
37 Measuring and control equipment	140	4.16%
38 Business supplies	129	3.83%
39 Shipping containers	48	1.43%
40 Transportation	36	1.07%
41 Wholesale	128	3.80%
42 Retail	120	3.57%
43 Restaurants, hotels, motels	30	0.89%
Total	3,366	100.00%

Notes: Industries are defined using Fama and French's (1997) 48 industry classifications.

4. EMPIRICAL RESULTS

4.1 Descriptive Statistics

Table 3 provides the descriptive statistics of all variables. The mean and median of CEO cash compensation (*CASH_COMP*) is 1.18 million and 0.94 million, respectively. The median is lower than the corresponding mean, and thus this study uses the logarithmic transformation of CEO compensation to alleviate the skewness in the data. The mean natural logarithm of CEO cash compensation (*LN_CASHCOMP*) and the corresponding median indicate that the skew is alleviated. The mean and median values of restructuring charge (*RCA_INC*) are -0.017 and -0.008, respectively, suggesting some firms recognize a higher value of restructuring charges. The mean of the restructuring charge reversals (*RRA_INC*) is 0.04% of the common equity; however, the median of the restructuring charge reversals (*RRA_INC*) is zero, suggesting half of the sample does not report restructuring charge reversals.

With regard to the descriptive statistics on the compensation committee effectiveness, Table 3 shows that 22.8% of observations have the CEO serving as the chairman of the board (*DUALITY*). The average tenure of the CEO (*TENURE*) is 7.66 years. 58.4% of the sample firms were appointed during the tenure of the incumbent CEO (*APPOINT*). On average, there are approximately 3 directors on a committee (*CMSIZE*), and the mean (median) of aggregate shareholdings of a compensation committee (*SHARES*) is 0.8% (0.1%). 18.6% of the firms have financial experts on their compensation committees (*FINEXPERT*). The mean (median) tenure of a director (*COM_TENURE*) is approximately 9 years, and thus 31.7% of the directors have at least 10 years of board service time (*SENIOR*). Finally, Table 3 also provides the descriptive statistics on the control variables. The means and medians of firm risk (*RISK*), firm leverage (*LEV*) and firm size (*SIZE*) are not skewed.

Table 3 Descriptive Statistics

	N	STD	MEAN	MIN	Q1	Median	Q3	MAX
CASH_COMP (in thousands)	3,366	916.137	1185.440	50.000	674.636	941.822	1318.440	8250.000
LN_CASHCOMP	3,366	0.595	6.884	3.932	6.516	6.849	7.185	9.018
ADJ_EARN	3,366	0.191	0.074	-0.698	0.000	0.089	0.166	0.991
RCA_INC	3,366	0.028	-0.017	-0.400	-0.019	-0.008	-0.003	-0.0001
RRA_INC	3,366	0.001	0.0004	0.000	0.000	0.000	0.000	0.013
HI_CCMQ	3,366	0.500	0.501	0.000	0.000	1.000	1.000	1.000
CCMQ	3,366	0.132	0.551	0.140	0.455	0.549	0.643	0.928
DUALITY	3,366	0.420	0.228	0.000	0.000	0.000	0.000	1.000
TENURE	3,366	6.295	7.660	2.000	3.000	6.000	10.000	58.000
APPOINT	3,366	0.294	0.584	0.246	0.257	0.573	1.000	1.000
CMSIZE	3,366	1.132	3.551	1.000	3.000	3.000	4.000	9.000
SHARES	3,366	0.034	0.008	0.000	0.000	0.001	0.004	0.187
FINEXPERT	3,366	0.389	0.186	0.000	0.000	0.000	0.000	1.000
COM_TENURE	3,366	4.357	9.121	1.000	6.200	8.500	11.000	23.000
SENIOR	3,366	0.295	0.317	0.000	0.000	0.333	0.500	1.000
RET	3,366	0.417	0.087	-0.876	-0.169	0.069	0.297	2.656
RISK	3,366	0.057	0.120	0.036	0.081	0.107	0.144	0.426
MB	3,366	2.212	2.719	0.136	1.479	2.130	3.191	24.787
LEV	3,366	0.186	0.512	0.071	0.384	0.529	0.640	0.982
SIZE	3,366	1.433	7.789	4.301	6.711	7.675	8.748	12.032

Notes: 1. N=3,366. 2. Variable Definitions: *CASH_COMP* is CEO salary plus bonus (in thousands) for fiscal year *t*; *LN_CASHCOMP* is the natural logarithm of adjusted CEO cash compensation; *ADJ_EARN* is defined as earnings before restructuring charge reversals, scaled by the average book value of common equity. *RCA_INC* is the amount of restructuring charges divided by the average book value of common equity. *RRA_INC* is the amount of restructuring charge reversals divided by the average book value of common equity. *HI_CCMQ* is an indicator variable that equals one for firms whose compensation committee monitoring quality (*CCMQ*) is above the median score for the sample, and zero otherwise. *CCMQ* is the comprehensive measure of compensation committee effectiveness, which is constructed using seven components: *DUALITY*, *TENURE*, *APPOINT*, *CMSIZE*, *SHARES*, *FINEXPERT*, and *SENIOR*. *DUALITY* is an indicator variable, coded as one if the CEO serves as the chairman of the board and zero otherwise. *TENURE* is measured as the number of years that the CEO has served the position in the firm. *APPOINT* is the proportion of CEO appointed directors on the compensation committee. *CMSIZE* is the number of directors on the committee. *SHARES* is the aggregate directors' shareholding. *FINEXPERT* is an indicator variable that equals one when there is a financial expert on the compensation committee, zero otherwise. *COM_TENURE* is measured by the number of years the director has been a member on the compensation committee of the firm in year t. *SENIOR* is the proportion of directors on the committee with 10 or more years of board service time. *RET* is the measure a firm's stock performance. *RISK* is the volatility of monthly stock returns. *MB* is firms' growth opportunities, measured as the market value of equity over the book value of equity. *LEV* is defined as total liabilities divided by assets. *SIZE* is measured as the log of total assets.

4.2 Correlation Analyses

Table 4 shows the correlations analyses among variables. The simple correlations between *LN_CASHCOMP* and *ADJ_EARN* are positive, indicating that regular earnings are used in the design of CEO compensation. The correlation between *RCA_INC* and *LN_CASHCOMP* is insignificant while the correlation between *RRA_INC* and *LN_CASHCOMP* is significantly positive, indicating that the restructuring charges are shielded from executive compensation but not for restructuring charge reversals. The correlation between *LN_CASHCOMP* and *SIZE* is 0.637, suggesting that larger firms provide more pay their CEOs. Overall, the correlations among other variables are relatively small, indicating that multicollinearity does not appear to be a problem in the regression model. To check for the potential of multicollinearity, this study also adopts the Variance Inflation Factor (VIF) in all regression tests.

Table 4 Correlation Analysis

	LN_CASHCOMP	*ADJ_EARN*	*RCA_INC*	*RRA_INC*	*HI_CCMQ*	*RET*	*RISK*	*MB*	*LEV*	*SIZE*
LN_CASHCOMP	1.000									
ADJ_EARN	0.297***	1.000								
RCA_INC	0.016	0.184***	1.000							
RRA_INC	0.041**	-0.030*	-0.111***	1.000						
HI_CCMQ	-0.113***	0.000***	0.014	-0.007	1.000					
RET	0.113***	0.158***	0.026	0.011	0.001	1.000				
RISK	-0.320***	-0.418***	-0.119***	0.096***	0.016	0.051***	1.000			
MB	0.212***	0.480***	-0.260***	0.086***	-0.075***	0.178***	-0.189***	1.000		
LEV	0.355***	0.166***	-0.265***	0.095***	-0.008	0.001	-0.184***	0.266***	1.000	
SIZE	0.637***	0.280***	0.021	0.007	-0.090***	0.019	-0.354***	0.151***	0.430***	1.000

Notes: 1. Pearson correlations are reported in the lower diagonal. 2. N=3,366. 3. see Table 3 for variable definitions. 4. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

4.3 Regression Analyses

The results for all hypotheses in this study are shown in Table 5. Panel A of Table 5 presents the coefficient estimates, and Panel B reports results for F tests of the estimated coefficients' difference and sum. Petersen (2009) and Gow, Ormazabal, and Taylor (2010) examine and find the effect of cross-sectional and/or time-series dependence on inferences in finance and accounting research, respectively. In particular, Gow et al. (2010) note that two-way clustering by firm and time, which can produce less biased standard errors and is robust to both forms of dependence, is necessary to produce valid inference[7]. Given the potential for both forms of dependence in our pooled dataset, we use two-way clustering by firm and year to estimate our all models[8].

Panel A of Table 5 reports coefficient estimates for the model (1) and model (2). In Panel A, the column of model (1) shows that earnings before restructuring charges (*ADJ_EARN*) is significantly and positively related to CEO compensation, consistent with prior evidence suggesting that accounting earnings plays an essential role in determining executive compensation (Sloan 1993). In addition, CEO compensation is insignificantly related to restructuring charges (*RCA_INC*) but positively correlated to the restructuring charge reversals (*RRA_INC*), which presents an asymmetric relation to CEO compensation for these two earnings components regarding restructuring activities. In particular, this result reveals that executive pay is enhanced by restructuring charge reversals, but not penalized by restructuring charges. Given the value-increasing implication of restructuring activities (e.g., Kross, et al. 2011), this treatment for compensation weights may be a reflection of shielding executive compensation from the adverse effect of these charges.

Panel B of Table 5 reports results for tests of sums and differences among the coefficient estimates in models (1) and (2), respectively. In Panel B of Table 5, the column of model (1) presents the results for F tests of *ADJ_EARN-RCA_INC* and *ADJ_EARN-RRA_INC*. The coefficient of *ADJ_EARN* is significantly larger than those of *RCA_INC* and *RRA_INC*, respectively. This result suggests that the earnings effects arising from restructuring activities (restructuring charges and reversals; *RCA_INC* and *RRA_INC*) are

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[7] Petersen (2009) uses simulations to consider two finance applications: asset pricing and capital structure. He concludes that in these settings ‘‘clustering standard errors by both firm and time appears unnecessary’’ (Petersen 2009, p473). In contrast, Gow et al. (2010) find that, in a variety of accounting applications, two-way cluster-robust standard errors are required for valid inferences. The difference in the findings between Gow et al. (2010) and Petersen (2009) is due to the fact that accounting variables, including executive compensation, exhibit greater dependence both over time and in cross-section than finance variables (Gow et al. 2010).

[8] Many studies control for industry- and year-fixed effects and use clustered standard errors by firm and year (e.g., Huang, Parker, Yan, and Lin 2014; Huang, Teoh, and Zhang 2014; Jha and Chen 2015). For example, Huang et al. (2014) indicate that "In addition to controlling for the industry and year dummies, we present clustered *t*-statistics by firm and year to correct for cross-sectional and time-series dependence of errors in all the relevant tests throughout the paper (Peterson 2009; Gow et al. 2010)". Two-way (firm and year) clustered standard errors are widely used in the accounting and finance literature (Huang et al. 2014; Huang et al. 2014; Jha and Chen 2015).

especially considered by the compensation committee when setting executive compensation. Combined with the result of insignificant coefficient of restructuring charges (*RCA_INC*), shown in model (1) column of Panel A, this implies that compensation committees completely shield CEO compensation from the income-decreasing effect of restructuring charges. This evidence supports the efficient contracting view because this compensation treatment avoids the penalty for restructuring charges with value-increasing potential. As for the result of restructuring charge reversals (*RRA_INC*), its coefficient is significantly positive (shown in Panel A) but less than reported earnings numbers (shown in model (1) column of Panel B as *ADJ_EARN- RRA_INC*). This suggests that income-increasing effect of the reversals still positively affect executive compensation. However, the compensation effect of reversals is adjusted downward due to the possible association of restructuring charge reversals with earnings management (Moehrle 2002).

The primary result of H1 is shown in model (1) column of Table 5, Panel B. The F-test in Panel B shows that the coefficient of *RCA_INC-RRA_INC* is significantly negative, suggesting that the compensation committee place lower compensation weight on restructuring charges compared to those on restructuring charge reversals. Therefore, this evidence supports H1, indicating that compensation committees motivate managers' long-term focus on restructuring activities by asymmetrically adjusting the compensation sensitivity to restructuring charges and restructuring charge reversals. Our finding is consistent with prior literature, which has shown the existence of an asymmetric compensation treatment for income-increasing and income-decreasing components (e.g., Gaver and Gaver 1998; Comprix and Muller 2006; Manchiraju et al. 2016; Chen and Tang 2017). In particular, our result of asymmetric compensation sensitivity to a specific activity (i.e., corporate restructuring) with two differential effects on executive compensation, is similar to that of Comprix and Muller (2006) whose specific economic activity is pension cost amounts.

H2 and H3 predict how compensation committee effectiveness affects the asymmetric compensation sensitivities to restructuring charges and restructuring charge reversals. In the model (2) column of Table 5, Panel A, the coefficient of *RCA_INC* (*RRA_INC*) represents the compensation sensitivity to restructuring charges (restructuring charge reversals) for firms with low-effectiveness compensation committees. Moreover, in the model (2) column of Table 5, Panel B, the coefficients of *RCA_INC+HI_CCMQ×RCA_INC* and *RRA_INC+HI_CCMQ×RRA_INC* capture the compensation sensitivities to restructuring charges and restructuring charge reversals, respectively, for firms with high-effectiveness compensation committees.

As for the empirical results of restructuring charges, the model (2) column of Panel B presents that the coefficient of restructuring charges is insignificantly negative for firms with highly effective compensation committees (the coefficient of *RCA_INC*+*HI_CCMQ*×*RCA_INC*=-0.008). However, the coefficient of restructuring charges (RCA_INC) shown in model (2) column of Panel A is significantly positive (at the 5% level; the coefficient of *RCA_INC*=0.042), which represents the result for firms with compensation committees characterized by low effectiveness. In addition, as shown in the model (2) column of Panel B, the individual shielding effects for low- and high-effectiveness compensation committees are captured by the coefficients of (*ADJ_EARN*-*RCA_INC*) and [*ADJ_EARN*-(*RCA_INC*+*HI_CCMQ*×*RCA_INC*)], respectively. The result shows that these two coefficients, 0.038 and 0.088, are significantly positive at the 10% and 5% levels, respectively, supporting the existence of shielding effects for either low- or high-effectiveness compensation committees.

The evidence on the shielding degree for various compensation committee effectiveness is discussed based on Adut et al. (2003)[9], as follows. Taken together with the insignificant coefficient on *RCA_INC*+*HI_CCMQ*×*RCA_INC* and the significantly positive coefficient difference of [*ADJ_EARN*-(*RCA_INC* +*HI_CCMQ*×*RCA_INC*)], this evidence indicates that highly effective compensation committees "fully" shield CEO compensation from the earnings effect of restructuring charges. Moreover, the combined results of the significantly positive coefficient on *RCA_INC* and significantly positive coefficient difference of (*ADJ_EARN*-*RCA_INC*) indicate that low-effectiveness compensation committees "partially" shield CEO compensation from the effect of restructuring charges. To test the expectation of H2, we observe the differential shielding effect of restructuring charges for high- and low- effectiveness compensation committees, which is captured by the significantly negative coefficient of interaction term " *HI_CCMQ*×*RCA_INC*" (at the 1% level), as shown in the model (2) column of Panel A. This evidence is consistent with H2 and suggests that highly effective compensation committees provide a greater degree of shielding effect for restructuring activities that are value-enhancing but income-decreasing. Our finding is consistent with prior literature that high-quality compensation committees design CEO compensation that will provide managers with stronger incentives for future performance (e.g., Sun et al. 2009).

With regard to restructuring charge reversals, the compensation effect for compensation committees that have high and low effectiveness are shown as the coefficient of *RRA_INC*+*HI_CCMQ*×*RRA_INC* (-0.008 in the model (2) column of Panel B) and that of *RRA_INC* (0.094 in the model (2) column of Panel A), respectively. These

[9] As in Adut et al. (2003), if the coefficient of the specific earnings component is: (1) less than or equal to zero, and (2) less than that of the adjusted normal earnings, then the compensation committees completely shield CEO compensation from the effect of this component.

two coefficients have opposite signs at the same significance level of 1%, suggesting that there exist highly different incentives designs for compensation committees with different effectiveness. Furthermore, the shielding effects of reversals reflect on the coefficients of [*ADJ_EARN*- (*RRA_INC*+*HI_CCMQ*×*RRA_INC*)] and [(*ADJ_EARN* -*RRA_INC*)], both of which are significant at the 1% level but have different signs (Coeff.=0.088 vs. Coeff.= -0.014 for high effectiveness vs. low effectiveness). Collectively, the evidence indicates that committees with low effectiveness do not filter out the income-increasing effect of restructuring charge reversals on CEO compensation, but highly-effective compensation committees largely filter out the effect. This evidence implies that better compensation committees are more likely to reduce the compensation sensitivity to reversals so as to avoid potentially opportunistic behavior.

We further statistically test the difference between these two groups based on the expectation of H3. As shown in the model (2) column of Table 5, Panel A, the coefficient of *HI_CCMQ*×*RRA_INC* is significantly negative (Coeff.=-0.102; at the 1% level) and then H3 is supported. This evidence indicates that, on average, highly effective compensation committees set a lower compensation weight on restructuring charge reversals than committees with low effectiveness. These overall results suggest that the recognition of restructuring charge reversals is penalized by highly effective compensation committees through completely shielding CEO compensation from the income-increasing effect of reversals, but are rewarded by committees with low effectiveness through placing a higher compensation weight (even higher than normal earnings).

Combining the results of restructuring charges with those of reversals, the evidence implies that firms with highly effective compensation committees encourage prospective restructuring activities, but, in contrast, filter out restructuring charge reversals from CEO compensation to avoid an opportunistic behavior of rent extraction. However, firms with compensation committees that have low effectiveness shield CEO compensation from the effect of restructuring charges to a less degree than firms with highly effective compensation committees. Additionally, it seems that these firms cause CEOs to receive excess pay due to the lack of filtering out the income-increasing effect of restructuring charge reversals from CEO compensation.

Regarding other variables, the results are described as follows. In the columns of model (1) and model (2), the indicator variable of compensation committee effectiveness, *HI_CCMQ*, is insignificantly negative, indicating that compensation committee effectiveness seems not to directly affect the level of CEO compensation. This implies that highly effective compensation committees may not engage solely in reducing CEO cash compensation level to mitigate the agency problem of excess pay, but rather in better relating their cash compensation to earnings components. Moreover, the coefficients of *RET* in both models are significantly positive, indicating that stock performance positively

affects CEO compensation (Hanlon et al. 2003). *RISK* has significantly negative coefficients in models (1) and (2), suggesting that firms with greater risk will tend to award less cash compensation (Core et al. 1999). The coefficients of *SIZE* in both models are significantly positive, which indicates that larger firms reward more compensation to managers (Himmelberg et al. 1999; Tosi et al. 2000; Harjoto and Mullineaux 2003).

Table 5 Results of Regression Analyses for CEO Compensation Sensitivity to Restructuring Charges and Restructuring Charge Reversals

Panel A: Coefficient Estimation			
Independent variables		model (1)	model (2)
INTERCEPT	?	0.000***	0.000***
		(53.860)	(53.990)
ADJ_EARN	+	0.076***	0.080***
		(4.820)	(5.030)
RCA_INC	+	0.013	0.042**
		(0.860)	(2.050)
RRA_INC	+	0.025**	0.094***
		(1.820)	(5.050)
HI_CCMQ	?	-0.005	-0.006
		(-0.390)	(-0.440)
HI_CCMQ×RCA_INC	?		-0.050***
			(-2.790)
HI_CCMQ×RRA_INC	-		-0.102***
			(-5.030)
RET	+	0.112***	0.112***
		(7.360)	(7.360)
RISK	?	-0.087***	-0.086***
		(-4.740)	(-4.740)
MB	+	0.012	0.004
		(0.710)	(0.260)
LEV	+	0.055***	0.055***
		(3.320)	(3.380)
SIZE	+	0.553***	0.548***
		(32.700)	(32.540)
INDUSTRY DUMMIES		YES	YES
YEAR DUMMIES		YES	YES
Adj R^2		0.563	0.569
Model F(p)		66.55***	66.55***
Panel B - F test for Summed Coefficients & Coefficient Differences			
ADJ_EARN-RCA_INC		0.064*	0.038*
ADJ_EARN-RRA_INC		0.051**	-0.014 ***
RCA_INC- RRA_INC		-0.013**	-0.052***
RCA_INC+HI_CCMQ×RCA_INC			-0.008
RRA_INC +HI_CCMQ×RRA_INC			-0.008***
(*RCA_INC +HI_CCMQ×RCA_INC*)-(*RRA_INC +HI_CCMQ×RRA_INC*)			0.0004***
ADJ_EARN-(*RCA_INC +HI_CCMQ×RCA_INC*)			0.088**
ADJ_EARN-(*RRA_INC +HI_CCMQ×RRA_INC*)			0.088***

Notes: 1. N=3,366. 2. see Table 3 for variable definitions. 3. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. 4. All *t*-values (in parentheses) in Panel A are based on one-tailed tests for variables with directional predictions, and are based on two-tailed tests for those without directional predictions. For F tests in Panel B, all significance levels are reported based on one-tailed tests. 5. All *t*-statistics are calculated based on the two-way (firm and year) clustered standard errors following Petersen (2009) and Gow et al. (2010). 6. VIFs are all smaller than 10. 7. Industries are defined using Fama and French's (1997) 48 industry classifications. The coefficients for the year and industry dummy variables are not reported in the tables as they are not of direct interest for this study.

4.4 Sensitivity Analyses

4.4.1 An additional consideration for opportunistic restructuring charge reversals

According to prior literature (John, Lang, and Netter 1992; Levitt 1998; Moehrle 2002), restructuring charge reversals may be induced by managerial earnings management incentives. Therefore, we conduct an additional analysis to examine how compensation committees adjust CEO compensation weight on the restructuring charge reversal conditional on whether the restructuring reversal is opportunistic or not. Furthermore, we also test whether this conditional asymmetric sensitivity is associated with compensation committee effectiveness. Referring to Moehrle (2002), we define restructuring charge reversals as opportunistic reversals *(EM_RRA*) if an observation's prior-year earnings exceed the current year pre-reversal earnings; otherwise, we define them as non-opportunistic restructuring charge reversals (*NOEM_RRA*). The results are shown in Table 6.

Regarding the compensation sensitivities to non-opportunistic and opportunistic restructuring charge reversals without considering compensation committee effectiveness, the model (1) column of Table 6, Panel A, shows a significantly positive coefficient for opportunistic restructuring charge reversals (*EM_RRA*) while insignificant for non-opportunistic reversals (*NOEM_RRA*). Furthermore, when considering the effectiveness of compensation committees, the model (2) column of both Panels A and B shows opposite results for highly and lowly effective compensation committees.

In model (2) column of Panel B, for highly effective committees, the coefficient of opportunistic reversals (*EM_RRA+HI_CCMQ×EM_RRA*) is significantly negative (Coeff.= -0.051; at the 1% level), and the coefficient of non-opportunistic reversals (*NOEM_RRA+HI_CCMQ×NOEM_RRA*) is insignificantly positive (Coeff.= 0.0003). In addition, these two coefficients are less than *ADJ_EARN,* as shown in the Panel B F-test results that both coefficients of *ADJ_EARN*-(*EM_RRA+HI_CCMQ×EM_RRA*) and *ADJ_EARN*- (*NOEM_RRA+HI_CCMQ×NOEM_RRA*) are significantly positive (Coeff.= 0.131 and 0.036, respectively; at the 1% level and 10% level). This evidence indicates that firms with highly effective compensation committees completely filter out the effect of opportunistic and non-opportunistic restructuring charge reversals from CEO compensation, and the former is even penalized by reducing executive compensation, as reflected in the significantly negative coefficient of *EM_RRA+HI_CCMQ×EM_RRA* (Coeff.=-0.051).

However, for compensation committees with low effectiveness, the result in the model (2) column of Panel A shows that both coefficients of *EM_RRA* and *NOEM_RRA* are significantly positive (0.067 and 0.048; at the 1% and 5% significance level, respectively). In addition, both *EM_RRA* and *NOEM_RRA* are significantly less than *ADJ_EARN*, as shown in the model (2) column of Panel B. Collectively, the combined

results suggest that compensation committees with low effectiveness just partially filter out the effect of both opportunistic and non-opportunistic restructuring charge reversals.

Table 6 Results of an Additional Consideration for Opportunistic Restructuring Charge Reversals

Panel A: Coefficient Estimation			
Independent variables		model (1)	model (2)
INTERCEPT	?	0.000***	0.000***
		(54.360)	(54.120)
ADJ_EARN	+	0.077***	0.080***
		(5.020)	(5.220)
RCA_INC	+	0.013	0.036**
		(0.900)	(2.080)
EM_RRA	+	0.022**	0.067***
		(1.690)	(4.290)
NOEM_RRA	+	0.015	0.048**
		(1.060)	(2.310)
HI_CCMQ	?	-0.005	-0.004
		(-0.380)	(-0.310)
HI_CCMQ×RCA_INC	?		-0.043***
			(-2.730)
HI_CCMQ×EM_RRA	-		-0.118***
			(-6.610)
HI_CCMQ×NOEM_RRA	-		-0.047***
			(-2.430)
RET	+	0.113***	0.110***
		(7.620)	(7.520)
RISK	?	-0.087***	-0.080***
		(-4.780)	(-4.640)
MB	+	0.011	0.006
		(0.700)	(0.390)
LEV	+	0.055***	0.051***
		(3.360)	(3.290)
SIZE	+	0.554***	0.553***
		(33.180)	(33.390)
INDUSTRY DUMMIES		YES	YES
YEAR DUMMIES		YES	YES
Adj R^2		0.555	0.567
Model F(p)		65.51***	65.51***
Panel B - F test for Summed Coefficients & Coefficient Differences			
ADJ_EARN-RCA_INC		0.065*	0.044*
ADJ_EARN-EM_RRA		0.055*	0.013***
ADJ_EARN-NOEM_RRA		0.062	0.032***
RCA_INC-EM_RRA		-0.010*	-0.031***
RCA_INC-NOEM_RRA		-0.002	-0.011***
RCA_INC+HI_CCMQ×RCA_INC			-0.007
EM_RRA +HI_CCMQ×EM_RRA			-0.051***
NOEM_RRA+HI_CCMQ×NOEM_RRA			0.0003
(*RCA_INC+HI_CCMQ×RCA_INC*)-(*EM_RRA+HI_CCMQ×EM_RRA*)			0.045***
(RCA_INC+HI_CCMQ×RCA_INC)-(*NOEM_RRA +HI_CCMQ×NOEM_RRA*)			-0.007
ADJ_EARN-(*RCA_INC+HI_CCMQ×RCA_INC*)			0.087*
ADJ_EARN-(*EM_RRA+HI_CCMQ×EM_RRA*)			0.131***
ADJ_EARN-(*NOEM_RRA+HI_CCMQ×NOEM_RRA*)			0.036*

Notes: 1. N=3,366. 2. see Table 3 for variable definitions. 3. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. 4. All *t*-values (in parentheses) in Panel A are based on one-tailed tests for variables with directional predictions, and are based on two-tailed tests for those without directional predictions. For F tests in Panel B, all significance levels are reported based on one-tailed tests. 5. All *t*-statistics are calculated based on the two-way (firm and year) clustered standard errors following Petersen (2009) and Gow et al. (2010). 6. VIFs are all smaller than 10. 7. Industries are defined using Fama and French's (1997) 48 industry classifications. The coefficients for the year and industry dummy variables are not reported in the tables as they are not of direct interest for this study.

As for the test for how compensation committee effectiveness affects the compensation sensitivity to restructuring related variables, the model (2) column of Panel A shows that the coefficients of interaction terms of *HI_CCMQ×RCA_INC*, *HI_CCMQ×EM_RRA* and *HI_CCMQ×NOEM_RRA* are all significantly negative (-0.043, -0.118, -0.047; at the 1% level). These findings suggest that highly effective compensation committees reduce more compensation weight on these restructuring-associated components, in particular for the reversals with suspicion of manipulating earnings, than compensation committees characterized by effectiveness.

4.4.2 Results for the subsamples of firms with long- and short-tenure CEOs

There is one concern that the results of this study may attribute to CEO tenure or management turnover. In this study, we have sought to avoid the vague of performance responsibility by excluding firms if their CEOs were not in office for two consecutive years. Nevertheless, the differential cases of CEO tenure may affect the results of this study. On the one hand, the new CEO may be brought in to undertake restructuring activities.[10] Then, it is more likely that this kind of restructuring charges is filtered from CEO compensation to a greater degree, thereby resulting in the asymmetric treatment for restructuring charges and restructuring charge reversals. On the other hand, Dechow et al. (1994) indicate that if the executive has an expected short horizon with the firm, then the executive will be more concerned with the short-term decrease in earnings. The compensation committee is therefore predicted to be more likely to filter restructuring charges from the compensation of executives with relatively short expected horizons with their firms. Accordingly, they find that the longer the CEO's tenure with the firm, the more the compensation committee will shield the executive from the adverse effect of restructuring charges.

Given the diverse expected impacts of CEO tenure on the shielding effect from different perspectives, and in turn on the asymmetric compensation treatment, we consider whether our results remain the same for subsamples of long-tenure CEOs and short-tenure CEOs. This study divides the sample into two subsamples: one subsample contains firms with long-tenure CEOs and the other contains firms with short-tenure CEOs. We repeat the primary regression analyses for subsamples and then present the results in Table 7.

First, the F-test result in Panel B of Table 7 shows that, for both subsamples, the coefficient of *RCA_INC* is significantly smaller than that of *RRA_INC* at the 0.01 level (*RCA_INC- RRA_INC*), consistent with our expectation. Therefore, H1 is still supported regardless of CEO tenure. That is, CEO tenure does not affect our findings regarding the asymmetric adjustment for restructuring charges and restructuring charge reversals.

[10] The authors thank the referee for the valuable suggestion.

Table 7 Results for Two Subsamples of Long-tenure CEOs and Short-tenure CEOs

Panel A: Coefficient Estimation		Long tenure(N=1,462)		Short tenure(N=1,904)	
Independent variables		model (1)	model (2)	model (1)	model (2)
INTERCEPT	?	0.000***	0.000***	0.000***	0.000***
		(38.580)	(39.800)	(36.790)	(36.430)
ADJ_EARN	+	0.097***	0.101***	0.052***	0.064***
		(4.330)	(4.440)	(2.490)	(3.150)
RCA_INC	+	0.009	0.045*	0.022	0.058**
		(0.350)	(1.550)	(1.200)	(2.410)
RRA_INC	+	0.055***	0.073***	0.048***	0.102***
		(3.000)	(3.210)	(2.990)	(3.880)
HI_CCMQ	?	-0.004	-0.022	-0.029**	-0.033**
		(-0.250)	(-1.110)	(-1.810)	(-1.810)
HI_CCMQ×RCA_INC	?		-0.092***		-0.061***
			(-4.070)		(-2.720)
HI_CCMQ×RRA_INC	-		-0.114***		-0.113***
			(-4.150)		(-4.290)
RET	+	0.108***	0.110***	0.117***	0.119***
		(4.520)	(4.810)	(6.190)	(6.320)
RISK	?	-0.116***	-0.127***	-0.055**	-0.061**
		(-4.720)	(-5.340)	(-2.050)	(-2.280)
MB	+	-0.013	-0.018	0.031*	0.023
		(-0.500)	(-0.740)	(1.440)	(1.100)
LEV	+	0.115***	0.096***	0.017	0.013
		(4.440)	(4.000)	(0.780)	(0.630)
SIZE	+	0.473***	0.470***	0.606***	0.604***
		(18.090)	(18.340)	(28.380)	(28.660)
INDUSTRY DUMMIES		YES	YES	YES	YES
YEAR DUMMIES		YES	YES	YES	YES
Adj R^2		0.529	0.545	0.589	0.593
Model F(p)		27.62***	28.77***	44.46***	44.23***
Panel B - F test for Summed Coefficients & Coefficient Differences					
ADJ_EARN-RCA_INC		0.088*	0.056*	0.031*	0.006*
ADJ_EARN-RRA_INC		0.042***	0.028***	0.004***	-0.038***
RCA_INC-RRA_INC		-0.046***	-0.028***	-0.027***	-0.044***
RCA_INC+HI_CCMQ×RCA_INC			-0.047***		-0.003
RRA_INC+HI_CCMQ×RRA_INC			-0.041***		-0.012*
(*RCA_INC+HI_CCMQ×RCA_INC*)-(*RRA_INC+HI_CCMQ×RRA_INC*)			-0.006***		0.009*
ADJ_EARN-(*RCA_INC+HI_CCMQ×RCA_INC*)			0.148***		0.067*
ADJ_EARN-(*RRA_INC+HI_CCMQ×RRA_INC*)			0.142***		0.075*

Notes: 1. Samples are further divided into two subsamples: the subsample of long CEO tenure includes firms with a CEO tenure longer than six years while the subsample of short tenure includes firms with a CEO tenure shorter than seven years. 2. see Table 3 for variable definitions. 3. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. 4. All *t*-values (in parentheses) in Panel A are based on one-tailed tests for variables with directional predictions, and are based on two-tailed tests for those without directional predictions. For F tests in Panel B, all significance levels are reported based on one-tailed tests. 5. All *t*-statistics are calculated based on the two-way (firm and year) clustered standard errors following Petersen (2009) and Gow et al. (2010). 6. VIFs are all smaller than 10. 7. Industries are defined using Fama and French's (1997) 48 industry classifications. The coefficients for the year and industry dummy variables are not reported in the tables as they are not of direct interest for this study.

Moreover, both interaction terms of *HI_CCMQ×RCA_INC* and *HI_CCMQ×RRA_INC* (as presented in the model (2) columns of Panel A) are significantly negative for two subsamples. The results show that for the two subsamples of firms with long-tenure CEOs and firms with short-tenure CEOs, compensation committee effectiveness affects the compensation sensitivity to restructuring related variables. Specifically, highly effective compensation committees place less compensation weight on these components than compensation committees characterized by low effectiveness. The results for H2 and H3 are unchanged qualitatively for firms with long- and short- tenure CEOs.

5. SUMMARY AND CONCLUSION

This paper, based on a US sample drawn from 1998 to 2011, examines how compensation committees treat restructuring charges and restructuring charge reversals in designing CEO cash compensation. The results of this paper show that, on average, the compensation sensitivity to restructuring charges is less than that to restructuring charge reversals. In addition, our results suggest that firms with highly effective compensation committees encourage prospective restructuring activities, but, in contrast, filter restructuring charge reversals from CEO compensation to avoid the opportunistic behavior of rent extraction. On the other hand, firms with compensation committees that have low effectiveness shield CEO compensation from the effect of restructuring charges to a less degree than firms with high-effectiveness compensation committee. Additionally, they do not filter out the income-increasing effect of restructuring charge reversals from CEO compensation, which is consistent with the view of managerial rent extraction.

This study complements the existing literature on restructuring activities, CEO compensation and compensation committee effectiveness. In particular, we contribute to prior evidence on the relationship between executive compensation and specific earnings components by shedding light on whether highly effective compensation committees look beyond the restructuring related earnings components in setting executive compensation. Accordingly, this study provides further implications for regulators, shareholders and directors that an effective compensation committee is essential for enhancing contract efficiency. It is thus worth noting how and whether a firm continuously improves the effectiveness of compensation committees.

Our study's primary limitation is that we cannot capture the real process of how an effective compensation committee evaluates the substances of restructuring charges and restructuring charge reversals. Therefore, we use the differential compensation treatment for these earnings components to infer the degree of mitigating managerial rent extraction. In light of this, future research can conduct in-depth interviews to provide insights into the compensation decisions for restructuring activities with diverse value perceptions.

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