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Our ref Treasury-submission-2013-Final

19 March 2013

Dear Sir/Madam

Submission - Exposure Draft - Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012

We are pleased to have the opportunity to comment on the Exposure Draft of the *Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012* ('ED') and associated regulations and commentary as released by the Parliamentary Secretary to the Treasurer.

Executive summary

Dividend test amendments

Our main concerns with the changes proposed in the ED are:

- The proposed amendments continue to link the ability to pay a dividend to the accounting standards or financial records. We continue to advocate a solvency test based on the test in New Zealand so as to foster further consistency as contemplated by the Trans-Tasman agreement between Australia and New Zealand.
- If a pure solvency test is not applied, the proposals as drafted are unclear whether companies required to prepare a financial report under the *Corporations Act 2001* ('Corporations Act') must comply with all recognition and measurement requirements of Australian accounting standards in order to determine their dividend payments – for example non-reporting entities preparing special purpose financial statements, may or may not comply with all recognition and measurement requirements of accounting standards.
- The ED does not address all concerns raised about the operation of section 254T, and its interaction with other parts of the Corporations Act and with tax legislation. For example the ED does not:

- Provide clarity on when a company needs to apply the capital reduction requirements of Part 2J.1 of the Corporations Act or when applying the dividend solvency test is sufficient. KPMG expects that companies will still need legal advice in circumstances where a payment to shareholders is not clearly 'out of profits'.

  In our view, the uncertainty regarding the interaction of these rules must be resolved unambiguously by legislation.
- Attempt to change how dividends are treated under tax legislation, so the issue of whether a payment to shareholders can be treated as a frankable dividend for tax purposes remains outstanding.
- Address past practice by companies that may have paid a dividend on the basis of legal advice that S254T overrides Part 2J.1.

Refer to Appendix 1 for further comments on the above issues along with other minor issues.

Remuneration report disclosure requirement improvements

KPMG welcomes the move to simplify executive remuneration disclosure requirements and supports aspects of the executive remuneration measures in the ED (Chapters 2, 3 and 4 of the Explanatory Memorandum).

However, we do not believe the proposed disclosures of remuneration outcomes will achieve the aims of improving remuneration disclosure and providing more transparent information to shareholders. There are significant problems with the ED in its current form, and we believe it will not work in practice if enacted in this form.

The problems with the current drafting of the ED and the reasons why it will not work in practice include:

- there are no definitions for critical terms such as "*total amount*", "*granted*" and "*paid*";
- there are no guiding principles by which to interpret these terms;
- there is no basis by which to determine what is to be included in the "*total amount*";
- the current drafting means remuneration actually received by an executive during the year will be double counted – first, under paragraph (ca) (iii) and then in a later year, under paragraph (ca)(i);
- there are no guiding principles on how, for example, a bonus should be reported - that is, in the financial year in which it is actually received or in the financial year in respect of which it is paid; and
- an individual executive will have differing amounts of remuneration reported against their name – the values in the statutory remuneration table calculated according to the accounting standards and the "*total amount paid*" under the proposed paragraph 300A(1)(ca). The ED does not require an entity to explain how it quantified the disclosed amounts, leaving a user without the information that is necessary to analyse and understand the disclosure.

In developing reforms to remuneration disclosure requirements, it is important to consider the purpose of the remuneration report and the need to legislate a "clearer categorisation of pay"[1]. The Government has indicated it recognises the purpose of the remuneration report is to provide a clearer explanation to shareholders and other stakeholders of the value of 'actual' remuneration received by executives. Given this, the proposed legislation should be drafted with regard for the guiding principle that the disclosure should be ***the value received by the executives*** of the 'actual' remuneration in a particular year.

This principle will then drive the nature of the disclosure and how it should be drafted.

We note our disappointment that the Government did not adopt the Corporations and Markets Advisory Committee's (CAMAC) recommendations, in its April 2011 report, "Executive Remuneration", as a package. The recommendations on the disclosure of actual pay (comprised of present pay and crystallised past pay) and future pay were intended to be given effect together with CAMAC's recommendation to remove the reference to the accounting standards from section 300A of the Corporations Act. While we acknowledge Treasury's concerns about comparability if left to each company's discretion, as CAMAC suggested, we think the CAMAC package reflects a better starting base in terms of a guiding principle and that the definitional issues with the Treasury proposals equal those of the CAMAC proposals.

Appendix 2 provides our specific comments on the proposed remuneration outcomes disclosures and other executive remuneration measures in the ED.

Appointment of auditors amendments

We support the amendment proposed. However consistent with our 2012 submission on Treasury's 2011 *Discussion Paper: Proposed Amendments to the Corporations Act*, we urge Treasury to clarify the definition of a small company limited by guarantee as provided in section 45B.

Refer to Appendix 3 for further comments.

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We would be pleased to discuss our comments with staff of The Treasury. If you wish to do so, please contact me on (03) 9288 5297, or Martin Morrow on (02) 9335 7058 or Ben Travers on (03) 9288 5279 for remuneration issues or Michael Voogt on (02) 9455 9744 for all other issues.

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[1] Treasury Media Release, "Reforms to further enhance Australia's executive remuneration framework", 21 February 2012

Yours faithfully

Kris Peach	Ben Travers
Partner, Department of Professional Practice	Partner, International Executive Services

Appendix 1 – Exposure Draft – Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012

Dividend test amendments

KPMG welcome the proposed amendments contained in the ED which deal with:

- companies which declare, as opposed to determine, dividends
- companies which are not required to prepare a financial report in accordance with Australian accounting standards and which, under the proposed amendments, may now determine net assets by reference to the financial records required to be kept under section 286 of the Corporations Act.

Solvency test

The proposed amendments continue to link the ability to pay a dividend to the accounting standards or financial records. We continue to advocate a solvency test based on the test in New Zealand so as to foster further consistency as contemplated by the Trans-Tasman agreement between Australia and New Zealand. The New Zealand solvency test includes a net assets test but without expressly requiring that assets and liabilities be determined in accordance with accounting standards or financial records.

A 'solvency test' is, in our view, the most workable outcome for a number of reasons:

- Neither the Corporations Act or the Income Tax Assessment Acts defines the term 'profits'. Instead legal precedents need to be considered. The majority of these precedents are outdated and complex and arguably not in line with current accounting standards, which are increasingly linked to fair values. This causes unnecessary costs and difficulties for directors when considering dividends and was one of the principal drivers for the change in the *Corporations Amendment (Corporate Reporting Reform) Act 2010*. We also note that Australian accounting standards are not clear in their concepts of what "profit" represents, as there is an additional wider notion of "comprehensive income", which is arguably a better reflection of performance during a period.
- Both the profits test and the assets exceeding liability test based on Australian accounting standards are not absolute indicators of solvency. Adopting a solvency test, based on all assets and liabilities, regardless of whether they are recognised for accounting, in determining whether a dividend can be paid provides a higher level of comfort to directors in complying with their obligations under section 588G to prevent insolvent trading.
- The solvency test is a concept that directors are already familiar with, given all companies required to prepare annual financial statements must also prepare a directors' declaration about the financial statements (section 295(4)), which includes a 'solvency declaration' in line with the section 95A solvency test.

- Current Australian accounting standards may result in more volatile accounting profits with the recognition of some non-cash and unrealised fair value movements. Further, a company may still have sufficient cash reserves to pay a dividend but may not have sufficient accounting profits – for example a company whose major asset is an intangible asset which produces positive cash flows and whose fair value is appreciating. Under Australian accounting standards the company is not able to reflect the fair value appreciation in the financial statements (no active market) and will need to amortise the asset over its useful life (non-cash expense). Similarly, an assets exceeding liability test based on Australian accounting standards may not permit the payment of dividends where assets such as intangible assets cannot be recognised at fair value.
- A 'solvency test' may also be considered to reduce the regulatory burden of the Corporations Act. Further, if Corporations Act dividends are able to be franked it may reduce the regulatory burden for income tax purposes. However, the 'solvency test' may not provide a link into Australian accounting standards – for example asset valuations may not be recorded in the financial statements.

Non-reporting entities preparing special purpose financial statements

As currently drafted it is unclear whether companies required to prepare a financial report under the Corporations Act must comply with all recognition and measurement requirements of Australian accounting standards – for example non-reporting entities preparing special purpose financial statements.

It may be that the reference to accounting standards could be interpreted as requiring only the accounting standards applied in the financial statements in the calculation of assets and liabilities (non-reporting entities may or may not apply all recognition and measurement requirements). To remove uncertainty for directors, it is important that the legislation be clear if that should be the case or not for entities that prepare financial statements.

Looking ahead, the Australian Accounting Standards Board ('AASB') is expected to make changes to the current differential reporting framework. KPMG notes that a possible outcome of the AASB's review is a requirement that all companies lodging financial statements on a public record prepare general purpose financial statements or that as a minimum all recognition and measurement requirements (including consolidation) of accounting standards are required. Accordingly, the final wording of the legislation when referring to accounting standards will be important.

Assets exceeding liabilities test

The ED requires that assets exceed liabilities immediately before declaration (if relevant) or payment of the dividend.

- In the case of mandatory dividends or liability-classified shares, the dividend may already be recognised as a liability. The legislation should not prevent payment of the dividend in a situation where liabilities exceed assets because the dividend has already been recognised.

- At the time when a company needs to determine whether assets exceed liabilities consideration is required as to whether the company must prepare a financial report under the Corporations Act. This may need reconsideration at each reporting date. For example, what happens in situations where at the last reporting date a company was required to prepare a financial report under the Corporations Act and at the next reporting date it is not, and say a dividend is declared between the first and second reporting dates? Is it the date on which the reason for the change arises that is used to assess to requirements of the proposed section 254T(4), i.e. if the dividend was declared before the reason for the change then apply the proposed section 254T(4)(a)?

  In KPMG's view the proposed legislation should be clarified to resolve this uncertainty.

Interaction between section 254T and the capital reduction rules

Effectively, because the capital reduction and taxation issues have not been addressed, companies will still be subject to a dual solvency and profits test when determining or declaring dividends. Whilst we acknowledge the difficulty in amending taxation requirements, we are concerned that the conflict between section 254T and Part 2J.1 has not been resolved. The Corporations Act requirements are currently a confusing mix of "capital maintenance" and "solvency" principles when assessing whether a company can make payments to shareholders and we encourage further debate and submissions to remove the inconsistencies. We note New Zealand has operated successfully for a number of years on a pure solvency principle.

Legal opinion continues to indicate that a 'section 254T dividend' ***may not*** be a reduction in capital 'otherwise authorised' by the law. The above current legal opinion is also consistent with the views expressed in the opinion attached to Australian Taxation Office Draft Taxation Ruling TR 2011/08.

The view adopted in the above legal opinion is that section 254T is not an authorising provision but imposes additional statutory constraints on what a company might otherwise do as a matter of company law. As a matter of company law, the legal opinion considers that, despite the 2010 amendments, dividends may still only be paid out of profits. Unless otherwise authorised (which the current or proposed sections 254T do not do), distributions may only be paid out of capital if they satisfy the requirements in Chapter 2J.

Explanatory Memorandum paragraph 1.16 appears to support this view, however the view expressed by Treasury in the 2011 *Discussion Paper: Proposed Amendments to the Corporations Act* would appear to be at odds with above legal opinion. We understand that there is separate legal opinion to the effect that section 254T does allow the payment of dividends from capital.

The result of the differing views is that companies currently do not know with certainty – and will not know if the ED goes ahead in its present form – whether it is permissible for directors to declare a dividend or determine that a dividend be paid where the payment has the effect of reducing the company's share capital.

In our view, the uncertainty regarding the interaction of these rules must be resolved unambiguously by legislation.

Income tax interactions

We acknowledge the comments in the draft Explanatory Memorandum that the proposed amendments to section 254T are not designed to change the taxation arrangements for dividends. Based on our discussion with Treasury, we understand that this is at least in part due to revenue concerns.

KPMG supports legislative amendments in the dividend area. The interaction between section 254T and the ability to pay franked dividends continues to be a difficult area for entities. KPMG supports initiatives to provide absolute clarity in this most important commercial area.

Commencement provisions and transitional no prejudice rule

The proposed amendments to the dividends payment tests are intended to apply from the date of Royal Assent subject to a transitional rule for companies which declare a dividend before, but pay it after, that date. Further, the proposals do not address past practice by companies that may have paid a dividend on the basis of legal advice that section 254T overrides Part 2J.1.

KPMG urges Treasury to consider providing directors with a “transitional no prejudice” rule for both corporations and income tax law in the event that they have paid dividends on the basis that existing section 254T authorised the payment of dividends out of capital. In our view this is appropriate given the intention of the 2010 amendments and the differing views which have subsequently emerged in relation to their effect.

Application of test to group companies

It is our view that currently the dividend test applies at each individual company level. So if a dividend is paid by a subsidiary to an intermediate parent (IP) then the IP also needs to determine whether it satisfies section 254T. Only if it does can the IP pay the dividend further up the ownership chain to the ultimate parent who in turn pays dividends to the owners (i.e. public). If dividends cannot be paid up the ownership chain so called ‘dividend traps’ are created.

KPMG would strongly support consultation and clarification in the Corporations Act of the following practical issues:

- When measuring assets and liabilities should it be conducted at each individual entity level or should it be completed at the group level?
- If at a group level what are the impacts of groups that may have:
  - guarantee arrangements for all or part of the group?
  - formed a tax consolidation group?
- What impact would there be on any dividend test for groups that have no formal cross guarantee between all entities within the group in place?
- How would a Corporations Act dividend test applied at a group level interact with the taxation treatment of dividends?

In our view it would be preferable for some form of cross guarantee to be in place if the dividend tests were to be applied/or could elected to be applied at the group level. This would assist directors in discharging their duties under section 588G to prevent insolvent trading.

Other

The ED does not address a number of other matters including:

- whether contingent liabilities and preferential dividend rights should be treated as liabilities
- whether the calculation of surplus assets should be modified where share capital is wholly or partly an accounting liability
- whether the existing rules governing the redemption of redeemable preference shares remains appropriate.

Appendix 2 – Exposure Draft – Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012

Remuneration report disclosure requirement improvements

1) Remuneration outcomes (Item 5)

The ED proposes the inclusion of three categories of pay for Key Management Personnel (KMP), **in addition** to the current statutory table under the Corporations Act that requires the fair value for accounting purposes to be used.

We have significant concerns if the drafting of the proposed legislation remains as it is.

The proposed categories of pay are intended to give effect to CAMAC's recommendation on providing detail of actual pay (present pay and crystallised past pay) and future pay. The Government rejected CAMAC's recommendation to remove reference to the accounting standards as there would be no requirement for numerical values to be calculated on the same basis and shareholders would not be able to make meaningful comparisons between remuneration reports[2]. And yet the proposed reforms also ascribe no definitions or valuation method to the three categories of pay. Given this, there will be differing interpretations and inconsistency of these new sets of values. For example, some companies may determine that no amount has been "*paid*" until the executive has sold the underlying shares and received the proceeds of sale. Alternatively, other companies may consider nothing to be "*paid*" until the executive is no longer under a restriction on sale on the basis that the executive is unable to realise any value until that time.

We also note the information required for the three proposed categories of pay is already available in the remuneration report in a different form. It would be better to replace existing requirements rather than take the 'add-on' approach proposed under the ED.

The accounting valuation method, currently required by the Corporations Regulations, does not reflect the **actual amount received by the executive** because the accounting standards require the value of share-based payments to be calculated at the time of grant and amortised over the vesting period. This valuation does not reflect the final amount that actually vests to the executive and does not reflect the value in the year of vesting.

Relevantly, the accounting valuations will differ if the performance hurdles are market conditions or non-market conditions and the amount included in the disclosure for any given year will be a combination of a number of different tranches of equity awards granted over multiple years. The accounting standards are designed to reflect **the cost to the entity** of executive remuneration, and not the value received by the executive. Accordingly, for users wanting to know t**he value received by the executive**, there is significant confusion regarding the value of equity awards provided to them.

Additionally, it is difficult to make any meaningful comparisons between companies.

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[2] Treasury Media Release, "Reforms to further enhance Australia's executive remuneration framework", 21 February 2012

The statutory remuneration table calculated according to the accounting standards reflects the cost to the company and it is questionable whether this is necessary on an individual executive basis. Accounting standards require disclosures of the totals for the entire KMP population in the financial statements, not by individual. Since the purpose of the remuneration report is for corporate governance regarding individual directors, it is more appropriate to provide disclosure using the **'value to the executive'** approach..

Unintended consequences will arise as a result of the proposed drafting of the legislation, including:

- The length of remuneration reports will increase and will potentially be more complex and confusing as shareholders try to reconcile the four different ways remuneration amounts will be presented. Transparency will not be improved with this restating of remuneration amounts.
- Given the confusion that may arise over the four categories proposed, companies may decide to adopt their own method of presentation (as has become more common practice over the last two years) in addition to the statutory requirements. This will lead to even further complexity and length of disclosures.

KPMG recommendations

- We strongly recommend that the ED not be legislated in its current form. We believe the comments above, particularly regarding the removal of the accounting concepts and streamlining the disclosure, should be included prior to implementation.
- We recommend removal of the requirement to use the accounting standards valuation method for individual KMP remuneration elements disclosed in the remuneration report in line with CAMAC's original recommendation.
- The statutory remuneration table required under Corporations Regulation 2M.3.03(1) should be removed from the remuneration report. The financial statements currently require entities to disclose the aggregate cost to the entity of KMP remuneration. We also note that the table we have proposed below will provide sufficient detailed information in respect of each KMP to better inform stakeholders.
- In the event the statutory remuneration table is retained in the remuneration report, we recommend the reporting in the statutory remuneration table be done on an aggregate basis for all KMP other than the CEO. This will ensure there are not two different amounts of remuneration for each KMP.
- We recommend the three categories of pay proposed in the ED be disclosed with a simplified approach reflecting current pay and future pay. We have set out our proposed method of disclosure below.
- Drafting of the legislation should ensure there are no overlapping requirements within section 300A of the Corporations Act 2001 and Corporations Regulation 2M.3.03(1).

Proposed remuneration disclosure

Remuneration table – current pay

KMP	***Current year pay, realised this year [1]***		***Prior year pay, realised this year [2,3]***	***Total pay realised this year***
	Fixed	***Incentive***		

Remuneration table – future pay

Current year, unrealised									
	Deferred cash awards			***Deferred equity awards***					
KMP	***Grant date***	***Amount***	***Vest date***	***Grant date***	***# securities***	***Exercise price (if any)[4]***	***Vest date***	***Share price @ grant $***	***Performance Conditions***
Prior year, unrealised									
	Deferred cash awards			***Deferred equity awards***					
KMP	***Grant date***	***Amount***	***Vest date***	***Grant date***	***# securities***	***Exercise price (if any) [4]***	***Vest date***	***Share price @ grant $***	***Performance Conditions***

Definitions

1. Current year pay, realised: this would cover fixed pay, non-monetary benefits and superannuation contributions made on behalf of the employee during the year, any bonus or short term incentive vested and receivable in respect of the financial year, shares or options awarded and vested during the financial year, and any other elements of remuneration awarded and vested during the financial year. It does not include the deferred part of any bonus, short term incentive, or other remuneration that will vest in a future year on achievement of a service condition and/or other performance measures.
2. Prior year pay, realised: this would cover any equity or other incentive awarded in a prior period that vested in the current year on the achievement of a service condition and/or other performance measures. The amount to be reported is to be fair valued at the vesting date. Vesting should be defined as the date when service and performance conditions have been achieved and the executive can no longer lose entitlement to the award.
3. Equity comprising listed shares should be valued at the vesting date, less any exercise price or other amounts payable (including amounts payable under loans to purchase shares) by the executive to acquire the equity. Vesting should be defined as the time when achievement of performance conditions has been determined and the executive can no longer lose entitlement to the award.
4. If a limited recourse or full recourse loan granted to acquire securities forms part of remuneration, show the amount payable under the loan under ‘exercise price’ at each reporting date until vested.

2) Remuneration Governance Framework (Item 4)

Proposed section 300A(1)(aa) of the ED enacts CAMAC’s recommendation that listed entities should provide a description of their remuneration governance framework. We agree that the specific details required should not be legislated. However, we are concerned with the possible disclosures that have been set out in the Explanatory Memorandum at section 2.13.

While the possible disclosures are not mandated, they will certainly influence the disclosures entities make to comply with the legislative requirement. We note that these possible disclosures have been taken directly from CAMAC’s report. We also note that CAMAC stated that there was significant opposition to these possible disclosures in its roundtable discussion. CAMAC’s position was that these specific disclosures should not be mandated and, in particular, noted its agreement with roundtable participants, that ***the disclosure requirements in relation to remuneration committees should not be more onerous than those for the audit committee.***

We also note concerns with the possible disclosure relating to “*management advice to the committee*.” As part of the working relationship between the board and management, there are likely to be numerous occasions where management provide advice to the committee and in many cases this will be in relation to commercially sensitive information. Advice is required from management to ensure the board and remuneration committee have the information necessary to make informed decisions. It is not practical for entities to disclose this

information. Rather, the way in which the board and remuneration committee makes decisions should be disclosed together with the process for dealing with conflicts of interest.

The proposed disclosure of the remuneration governance framework may be located (a) within the remuneration report, (b) outside the remuneration report but within the directors' report; or (c) within the financial report for that financial year.

Allowing the disclosure to be located within the financial report could make finding the disclosure more cumbersome for the user.

KPMG recommendation

KPMG recommends that the list of possible disclosures in the Explanatory Memorandum be reconsidered and the specific possible disclosures, in relation to the qualifications, experience and composition of the remuneration committee and management advice to the committee, be removed.

Guidance in the Explanatory Memorandum should focus on the decision process adopted by the committee and could include the following possible disclosures:

- approach/guiding principles or remuneration philosophy adopted by the board and remuneration committee
- key responsibilities of the remuneration committee
- key areas of focus by the remuneration committee in the reporting year
- remuneration committee's approach to risk management
- protocols in relation to engaging with management and external advisers
- process undertaken for the review of the remuneration levels for the Chief Executive Officer and other KMP remuneration levels and role of both the board and remuneration committee.

We consider that allowing the framework to be disclosed in the notes to the financial statements would mean the disclosure is too far distant from other remuneration and governance disclosures. We recommend only allowing the disclosure of the remuneration governance framework to be set out in either:

a) The remuneration report within the directors report, along with other remuneration disclosures, or

b) The directors report, along with other governance disclosures.

3) Options (Items 6 & 7)

KPMG welcomes the proposed changes in relation to options which will simplify disclosure requirements.

There are other requirements of the Corporations Act or Regulation 2M.3.03(1) that either add very little value to a reader, or are rarely required in a company's circumstances. In our view the readability of the remuneration report could be improved by their deletion without the loss of any relevant or significant information for shareholders.

KPMG recommendation

We consider that the following requirements of Regulation 2M.3.03 could be deleted without diminishing the quality of information provided to shareholders:

- Regulation 2M.3.03(1)(Item 12)(h) – estimates of the maximum and the minimum possible total value of the bonus or grant (other than option grants) for financial years after the financial year to which the report relates.
    - For awards that affect future periods, the minimum amount is always 'nil' because the amount could be forfeited and therefore result in a nil value. Disclosure of a nil value takes up space in a remuneration report without adding any value to the reader.
    - Among companies disclosing a maximum amount for grants other than options, there is diversity in practice in valuing the 'maximum' possible value, due to no guidance existing in accounting standards or the Regulation on how to measure this amount. This lack of consistency makes the information less valuable and reliable to a user. The ED proposes a new disclosure for future pay, which will incorporate a total measure for the items covered by this disclosure, rather than award by award. A company that discloses an amount for 'future pay' should not also need to disclose the maximum future amount for each grant of incentive pay.

4) Benefits on termination (Item 8)

KPMG supports the proposed reforms to increase transparency on termination benefits. We note there are some potential issues arising from the wording of the ED.

- Use of the phrase "to be given" is forward looking and would require disclosure of potential payments for each KMP in each reporting period. Our understanding of the intention of these provisions, which is reflected in the wording of the Explanatory Memorandum, is that disclosure is only intended to capture benefits that result from an 'actual' termination in the relevant reporting year, rather than future termination benefits that could or might be paid.
- No definition is provided on what "detail" of benefits is required. Is the intention to require amounts and/or the nature of the benefits?
- A company might not enter into an arrangement with a former KMP until after the period end. If the former KMP is not captured in the subsequent remuneration report, that arrangement would not be disclosed. Also, with the current wording, a company could avoid disclosing an arrangement under (iii) by simply not finalising the arrangement until after period end.

KPMG recommendation

We recommend the following revisions are made:

- The wording should be revised to make it clear that disclosure is only required for terminations occurring in the current reporting period, consistent with the intent described in the Explanatory Memorandum section 2.21.
- The required "details" of benefits should be defined to ensure appropriate disclosure is achieved.
- Lastly, in order to capture 'other' arrangements in respect of KMP that are entered into after period end, but before the remuneration report is issued, we recommend amending the third paragraph to include agreements or arrangements entered into subsequent to the financial year, but before the date of the remuneration report.

Therefore, we recommend that the paragraph is reworded to avoid a misunderstanding of its objective and scope. For example, the paragraph could read:

"(ea) for each person referred to in paragraph (c), disclose the nature and amounts of:

(i) benefits that were given by the company or a related body corporate during the financial year to the person in connection with the person's retirement from an office or position of employment in the company, if a failure to give the benefit would constitute a contravention of a law in force in Australia or elsewhere (otherwise than because of a breach of contract or a breach of trust); and

(ii) benefits that were given by the company or a related body corporate during the financial year to the person in connection with the person's retirement from an office or position of employment in the company, if subparagraph (i) does not apply to the benefit; and

(iii) any other benefits given to the person, or arrangements entered into or to be entered into with the person, during or since the end of the financial year, by the company or a related body corporate, that relate or that will relate to a period beginning after the person's retirement from an office or position of employment with the company (whether or not the benefit is required to be given or the arrangement required to be entered into under a contract or in accordance with any law); and"

5) Clawback of remuneration (Item 9)

We welcome the requirement to report 'clawback' of remuneration on an 'if not, why not' basis and the flexibility given to companies to determine the appropriate method of 'clawback'. We question whether the requirement to report 'clawback', in relation to a material misstatement or omission, is sufficient to achieve the objective of this reform, given the infrequent nature of material misstatements.

We also note the ability to clawback remuneration from executives who have ceased employment is limited, particularly since equity is taxed on termination.

KPMG recommendation

From a governance perspective, boards want to be able to structure long term incentives that remain subject to the original performance conditions for the original performance period, notwithstanding an employee's termination of employment. The current tax legislation imposes tax on the market value of the equity instrument at the date of termination of employment, nothwithstanding that the vesting of the award remains subject to satisfaction of performance conditions in the future. We recommend the Government consider the removal of termination of employment as a taxing point for equity incentives, to facilitate improved governance of equity incentives that can remain subject to performance hurdles and clawback after termination of employment.

On this basis the equity grants made to executives would continue to remain subject to vesting at the end of the original vesting period until satisfaction of the relevant performance hurdles. In this way there would be no acceleration of equity grants to an earlier point in time (on the basis that the executive needs liquidity to meet the tax liability) nor would the termination benefit provisions of the Corporations Act be triggered.

6) Relieving certain unlisted companies from the obligation to prepare a remuneration report (Item 10)

The Explanatory Memorandum explains that the amendment is meant to align the requirement to prepare a remuneration report with the requirement for the remuneration report to be subject to the 'two-strikes' requirement of section 250U.

Section 250U only applies to 'listed companies'. But the amendment to section 300A(2) would say that section 300A applies to "any listed disclosing entity that is a company". It is not clear why different wording should be used between section 250U and section 300A if the intent is for the requirements to cover the same types of entities.

It is unclear to us whether there are any listed companies that are not disclosing entities.

KPMG recommendation

We recommend that section 300A(2) instead be revised to say:

"This section applies to any listed company".

If this change is not accepted, then we recommend that the title of section 300A be amended to be consistent with section 300A(2):

Change from:

Annual directors' report – specific information to be provided by listed companies

To:

Annual directors' report – specific information to be provided by listed disclosing entities that are companies.

7) Other comment – consistency with Section 300 of the Corporations Act

Section 300A(1)(c) was amended in 2010 to remove the reference to the five most highly remunerated officers of the company or group in the context of a remuneration report. Since that time, the remuneration report only covers the KMP of either the consolidated group or the company, as applicable.

However, section 300(1)(d)(ii) still requires disclosure of options that are granted to *'any of the directors or any of the 5 most highly remunerated officers of the company (other than the directors)'*.

It is unclear why the disconnect exists between section 300(1)(d) and section 300A(1)(c) in terms of individuals covered by the disclosure.

Section 300(1)(d) does not require disclosure of all KMP, and in some instances might require disclosure of options granted to individuals not covered by the remuneration report (officers that are not KMP).

KPMG recommendation

We recommend that the persons covered by section 300(1)(d)(ii) be aligned to section 300A(1)(c) with an amendment as follows:

"granted to <u>each member of the key management personnel</u>"

Appendix 3 – Exposure Draft – Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012

Appointment of auditors amendments

The ED proposes to remove the requirement to appoint an auditor for companies limited by guarantee with annual revenue less than $1 million. We welcome this administrative relief.

However, the ED proposes no changes to the definition of a small company limited by guarantee as provided in section 45B, and so there remains confusion as to whether a company meets the small test.

The wording in section 45B(1)(c) states that to be 'small', where the company limited by guarantee is required by accounting standards to be included in consolidated financial statements, the consolidated revenue of the consolidated entity should be less than the threshold amount. The issue is around interpretation of what revenue amount should be compared for an entity that is itself a subsidiary.

If we look at the following example:

- Assume that both Company A and Subsidiary C are companies limited by guarantee and Subsidiary B is a large proprietary company. Company A controls subsidiaries B and C. There are no other entities in the group.
- For Company A the revenue in its consolidated financial statements is the amount to compare against the defined threshold amount.
- For Subsidiary B the revenue in its financial statements is the amount to compare against the defined threshold amount in section 45A.
- However for Subsidiary C, should the revenue test under section 45B be on the revenue:-
  - in the financial statements of Subsidiary C itself; or
  - in the consolidated financial statements of Company A?

At present we believe there is inconsistent application of the above. It is arguable that the intent of the wording in section 45B(1)(c) is not clear and that the Explanatory Memorandum to the *Corporations Amendment (Corporate Reporting Reform) Act 2010* implied the test would be consistent with testing for determining small proprietary companies under section 45A, i.e. in the above example look at the revenue of Subsidiary C only.

KPMG considers that Treasury should amend the Corporations Act to clarify that the test was intended to operate as section 45A operates.