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Langton Crescent
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15 March 2013

To whom it may concern

Submission on the draft Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012

Thank you for the opportunity to comment on the draft *Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012* (the draft Bill).

PwC supports the draft Bill's objectives to improve the information provided to investors about the remuneration of key management personnel and address issues surrounding the operation of the dividends test. We agree that legislative change is required to address these issues.

We agree that there is a need to provide investors with the remuneration information proposed by the draft Bill. However there is also a need to improve remuneration reporting by reducing the complexity and volume of disclosure. In the Appendix to this letter we suggest alternatives to some of the proposals included in the draft Bill, which we believe would achieve the draft Bill's objectives while reducing the complexity of remuneration reports.

The proposed changes to the test for the payment of dividends address practical issues with the existing test, however uncertainty remains about the interaction between the test for payment of dividends in section 254T of the Corporations Act and the capital maintenance provisions of section 256B. Further legislative change is needed to address this issue.

Our detailed responses to each of the proposals are included in the Appendix.

We would welcome the opportunity to discuss our views. Please contact Jan McCahey on (03) 8603 3868 to discuss issues relating to accounting, financial reporting and remuneration disclosures, Andrew Wheeler on (02) 8266 6401 to discuss legal issues, or Wayne Plummer on (02) 8266 7939 to discuss taxation issues.

Yours sincerely

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Appendix: PwC's comments on the specific proposals raised in the draft Bill

Dividends test amendments

The adoption of the current dividends test has created a regulatory burden for companies that are not otherwise required to comply with Australian Accounting Standards by expecting them to calculate assets and liabilities by reference to the accounting standards. There is also some confusion in practice about when the test should apply if the directors choose to determine a dividend in accordance with section 254U of the *Corporations Act 2001* ("the Act") instead of declaring it. In our view, the proposed new section 254T of the Act addresses these issues.

However, there remains a body of legal opinion that common law only permits dividends to be paid out of profits, and that section 254T places a restriction on the payment of dividends rather than explicitly authorising dividends. This uncertainty arises from the negative language used by section 254T: "A company must not declare a dividend unless..."

Section 256B(1) of the Act applies to reductions in share capital that are not 'otherwise authorised by law'. If the view that section 254T merely restricts, rather than authorises, payment of a dividend is upheld then a dividend that is sourced from share capital would not be 'otherwise authorised by law' and the requirements of section 256B(1), including a requirement for shareholder approval, would apply. This opinion is expressed, for example, in the joint opinion to the Australian Taxation Office by AH Slater QC and JO Hmelnitsky.

We understand that the intention of the 2010 amendment to the dividends test was to remove the profits test for the payment of a dividend; however, the continued uncertainty described above demonstrates that a further amendment is required to fully achieve clarity in this area. In our view, this issue could be addressed by drafting section 254T positively, for example "A company may only declare a dividend if...", which would authorise, rather than restrict, the payment of a dividend. We note such positive language has been used in the proposed new paragraph 9.1 of the small business guide in Part 1.5 of the Act. To make it clear that there is no common law profits test, we also recommend that a new section 254T(5) is inserted to state "A dividend may be paid from profits, share capital or any other source".

We also recommend, as a matter of principle, that the ability of a company to frank a dividend should be matched to its ability to pay a dividend. If the above recommendation is adopted in relation to the wording of section 254T, an amendment will need to be made to the Income Tax Assessment Act 1936 will be needed to align the treatment of a dividend for taxation purposes with the revised test for the payment of a dividend.

Improving disclosure requirements in the remuneration report

Disclosure of remuneration outcomes

The draft Bill proposes that, in addition to existing remuneration disclosures, companies will be required to disclose for each key management personnel (KMP):

- The amount that was granted before the financial year and paid to the person during the financial year;

- The amount that was granted and paid during the financial year; and
- The amount that was granted but not yet paid during the financial year

Currently companies are required to report KMP remuneration on a consistent basis with the amount recognised as an expense for the financial year in accordance with accounting standards. For example, the expense for a long-term cash bonus is calculated by estimating the future payment and spreading this amount over the financial years in which the entitlement to the bonus is earned (the 'vesting period'). The expense for a share-based payment is determined by calculating the fair value of the award at the beginning of the vesting period and spreading it over the vesting period.

Reporting remuneration on the basis of the amounts recognised as an expense is often criticised because the expense recognised in a financial year does not necessarily reflect the benefit that will be received by the KMP at the end of the vesting period. Many investors and companies believe that the amount actually received by the KMP is more useful than the expense in helping investors decide on their vote on the remuneration report. As a result, many companies voluntarily provide additional information on remuneration outcomes in their remuneration reports.

In our view, KMP remuneration should be disclosed on the basis of the benefit actually received by the KMP rather than the expense for the financial year. Disclosing information on actual remuneration outcomes provides investors with a better measure of the benefit received by KMP than is provided by the accounting expense.

However, we do not support the draft Bill's proposal to do this by providing additional disclosures rather than replacing existing disclosures. The draft Bill would require two sets of information, measured on different bases, to be disclosed. In our view, this would increase the complexity of the remuneration report, would be likely to confuse investors, and would increase the burden on preparers. We recommend that the remuneration outcome disclosures replace existing disclosures instead of supplementing them. We believe the accounting expense provides useful information on the financial performance of the company so it is appropriate that it continues to be recognised in the financial statements. However, we don't believe it is necessary for the remuneration disclosures to be consistent with the accounting expense because the remuneration outcome provides investors with more relevant information on remuneration.

We recognise that information on the value of long-term incentives and share-based payments at the date of grant is of value to investors. However, Corporations Regulations 2M.3.03(1)(12), 2M.3.03(1)(15) and section 300A(1)(e)(ii) of the Act already require detailed disclosures of grants of long-term incentives and share-based payments including the fair value per option/right granted, the fair value of options granted during the year as remuneration, and the maximum and minimum possible total value of the bonus or grant for future financial years. However, the Act and the Regulations do not require disclosure of the total value of cash bonuses granted to each KMP at the date of grant; we believe this requirement should be added to regulation 2M.3.03(12) or to section 300A of the Act. In our view, this would ensure that the grant date value of all cash- and share-based long-term incentives is disclosed without adding unnecessary complexity.

The views we have expressed above are supported by the findings of the UK Financial Reporting Council's investigation into remuneration disclosure, which was conducted by the FRC's Financial Reporting Lab in collaboration with investors. The FRC's report "*Lab project report: A single figure for remuneration*" recommended that long-term bonuses and share-based payments are disclosed in

the remuneration report only in the financial year in which they vest, and that it should be measured at the amount paid (or to be paid). The amount disclosed would be measured at the amount to be paid to the KMP, net of any exercise price payable by the KMP, and disaggregated only into amounts paid in the financial year and amounts yet to be paid. In our view, disclosure of remuneration on this basis would reduce complexity while still providing investors with information that is relevant to their decision-making.

If the proposals contained in the draft Bill are adopted, we believe it will be necessary to clarify how the amount paid should be measured. For example, it is not clear how a share-based payment would be measured: Would it be based on the market price of the company's shares at the beginning of the vesting period (as required by the relevant accounting standard), when the award vests, or when the KMP receives the shares? We encourage the Government to clarify this aspect of the draft Bill prior to its finalisation.

Remuneration governance framework

We agree that additional disclosure of a company's remuneration governance framework would provide useful information to investors and encourage good governance. However, in our view governance disclosures should be provided as part of the company's report on corporate governance. Therefore, we suggest that this issue would be better addressed by enhancing the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations.

Disclosure of lapsed options

We agree with the proposal to require disclosure of the number of lapsed options and the year in which they were granted, in place of the existing requirement to disclose the value of lapsed options.

Disclosure of payments made to KMP on retirement from the company

We agree that disclosure of statutory and other payments to KMP on termination and disclosure of post-severance arrangements would provide useful information to investors. However, if this proposal is adopted, we encourage the Government to clarify the treatment of superannuation payments. Corporations Regulation 2M.3.03 already requires disclosure of post-employment benefits, including superannuation, on the basis of the amount recognised as an expense in the financial year. Therefore if superannuation is included in the proposed disclosure it will effectively be disclosed twice. We suggest that any superannuation benefits that have already been disclosed as post-employment benefits should be excluded from the proposed disclosure requirement.

Other suggested changes

The Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011 replaced the requirement to disclose remuneration information for a listed company's five most highly remunerated executives with a requirement to disclose information for the company's KMP. However section 300(1)(d) of the *Corporations Act* continues to require all companies to disclose details of options granted to any of the directors or any of the five most highly remunerated officers of the company. This is inconsistent with the remuneration reporting requirements of section 300A and confusing for companies and investors.

We recommend the Government amend section 300(1)(d) to require disclosure of options granted to KMP instead of the directors and the five most highly remunerated officers.

Clawback of remuneration

We agree that disclosure of whether an overpayment to KMP as a result of a material misstatement in a prior year will be clawed back provides useful information to investors. However we suggest that the language used in the proposed amendment should be aligned with the relevant accounting standard, AASB 108 "Accounting Policies, Changes in Accounting Estimates and Errors". We recommend that the requirement to disclose whether an overpayment to KMP has been clawed back applies when financial statements have been restated to correct a material prior period error.

We recommend that further consideration be given to whether the disclosure should only be required where companies become aware of material misstatements in any of their three previous financial statements. This three year limit appears to be arbitrary. While we recognise that there could be practical limitations on the ability of a company to claw back overpayments made more than three years ago, this could be dealt with in the company's explanation of why no amounts have been clawed back.

Relieving certain unlisted companies from the obligation to prepare a remuneration report

We agree that many of the remuneration reporting requirements in section 300A of the Act are not meaningful to investors in unlisted companies. Therefore, we support the proposal to relieve unlisted companies that are disclosing entities from the requirement to prepare a remuneration report.

We also recommend that the Government consider providing similar relief to other types of entities. For example, some listed companies have subsidiaries which are also classed as listed disclosing entities by virtue of having debt instruments listed on the Australian Stock Exchange. These listed subsidiaries would not be relieved of the requirement to prepare a remuneration report by the proposed amendment, but many of the remuneration disclosure requirements would not be meaningful because, for example, remuneration policies are often set by the parent entity by reference to the performance of the whole group. We recommend that section 300A is amended to permit such companies to refer investors to the parent entity's remuneration report.

Relieving public companies from the obligation to appoint auditors if audits are not required

We agree with the proposal to relieve public companies that are not required to have their financial reports audited from the requirement to appoint an auditor.

Remuneration setting for certain statutory office holders

We agree that the Remuneration Tribunal is better placed to determine the remuneration of the offices of the Financial Reporting Council, the Australian Accounting Standards Board and the Auditing and Assurance Standards Board than the Minister or the FRC. Therefore we support the proposal to amend the ASIC Act to transfer responsibility for determining the remuneration of these offices to the Remuneration Tribunal.