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General Manager
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

15 March 2013

Dear Sir/Madam

EXPOSURE DRAFT - CORPORATIONS LEGISLATION AMENDMENT (REMUNERATION DISCLOSURES AND OTHER MEASURES) BILL 2012

BDO welcomes the opportunity to provide a submission on the exposure draft (Exposure Draft) of the *Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012*, released by Treasury for public consultation on 14 December 2012.

Our submissions are limited to Items 3 to 11 of Schedule 1 to the Exposure Draft, which provide for the repeal of existing s254T dividend requirements of the Corporations Act 2001 and substitution of a new s254T, as well as additional disclosure requirements in remuneration reports of listed companies (S300A).

Please refer to our detailed comments included in the appendices to this letter.

If you have any comments regarding our submission, please do not hesitate to contact Sheryl Levine at sheryl.levine@bdo.com.au.

Yours sincerely

BDO Australia Limited

Timothy Kendall

National Audit Leader

DIVIDENDS

While some of the issues raised in Discussion Paper *Discussion Paper - Proposed Amendments to the Corporations Act* (the Discussion Paper) with regard to dividends and s254T have been addressed in the Exposure Draft, there are a number of areas which we believe, have either not been addressed, or the proposed drafting in the Exposure Draft requires improvement to make it functional in practice. These include:

- Authorisation of dividend payments out of funds that not do comprise profit
- Timing of application of Accounting Standards
- Financial reporting test - 'look back' test.

Authorisation of dividend payments out of funds that not do comprise profit

While the proposed new s254T addresses some deficiencies of the existing s254T, such as addressing payment, as well as declaration of dividends, it retains a notable deficiency of the existing s254T. That deficiency is that both the existing version of s254T and the proposed new version of s254T fail to adequately authorise the payment of dividends out of funds that do not comprise profits. This same deficiency, in the existing form of s254T, was addressed in our submissions (Previous Submissions) to Treasury of 27 January 2012 in respect of the *Discussion Paper - Proposed Amendments to the Corporations Act* (the Discussion Paper), released by Treasury for public consultation on 28 November 2011. For your convenience we have reproduced the relevant portion of our Previous Submissions:

No explicit identification of funds from which a company is authorised to pay dividends

The replacement of the then existing s254T by the Corporations Amendment (Corporate Reporting Reform) Act 2010 was presented as a solution to problems arising in the application of the previous s254T, which provided:

“A dividend may only be paid out of profits of the company.”

In particular, it was suggested that the new s254T overcame the problem of identifying what were profits of the company, for that purpose. It might be noted that the previous iteration of s245T both identified the authorised source of the funding of dividends (profits) and limited the source of dividends to that same source of funds. Arguably the current s254T introduced its own problems in respect of the identification of funds available for payment of a dividend.

Current s254T is formulated as a prohibition, rather than an authorisation. While it prescribes the conditions which must be present after the payment of a dividend, it is, in fact, silent on the question of the funds from which such dividend may be paid. There is a real risk that a court called upon to interpret existing s254T, particularly in light of the long history, under company law, of the differential treatment of dividends, paid out of profit, on the one hand, and return of capital to shareholders, on the other, would interpret s254T as still requiring that

dividends be paid out of profit. This risk is exacerbated by the separate and different requirements, under Chapter 2J, for the return of capital by a company to its shareholders.

Regardless of the approach adopted otherwise, if it was indeed intended that the section authorise payment of dividends out of share capital this should be explicitly authorised in the provisions of the section. This might be accomplished with a provision such as the following:

“Subject to the following subsections, a company may pay dividends from any funds available to it, including share capital.”

In addition, it might be prudent to provide statutory confirmation that the separate requirements for return of capital to shareholders, in Chapter 2J, need not be followed, in respect of a dividend, to the extent that it is paid out of share capital.

There would also be an argument that such amendments should be retrospective in application to the time of the 2010 amendments to s254T in order to address payments of “dividends” out of share capital that have been made as a consequence of such changes and the representations made in respect of such changes in the accompanying Explanatory Memorandum.

The concerns that we have voiced about the funds available for payment of a dividend are not unique. In this regard we refer to draft Taxation Ruling TR 2011/D8 and the joint opinion of A H Slater and J O Hmelnitsky made public by the Australian Taxation Office (ATO) in the context of the release of such draft ruling.

We note that draft Taxation Ruling TR 2011/D8 has now been released by the ATO in final form as TR 2012/5. The final form of the ruling maintains the position that s254T only authorises payment of dividends out of profits and is linked to the joint opinion of A H Slater and J O Hmelnitsky, which expresses a similar view. While those views are expressed in relation to the current form of s254T, there is no reason to conclude that different views would be formed in interpreting the proposed new form of s254T.

Timing of application of Accounting Standards

The references to “at a particular time” in proposed s254T(4) and “the time” and “that time” in proposed s254T(4)(a) is confusing and we recommend that these be redrafted to clarify what is meant by these terms.

The proposed wording of s254T(4) refers to “at a particular time” in the introduction.

Proposed wording of s254T(4)(a) refers to “...for the financial year during which the time occurs...” and also “...accounting standards in force at that time...”.

In our view, proposed s254T(1) and (2) are clear that the timing for the assets test is “immediately before” the dividend is declared or paid. Therefore, proposed s254T(4) could merely say “The assets and liabilities of a company are to be calculated for the purpose of this section in accordance with:”.

We also recommend that proposed s254T(4)(a) be reworded as follows:

“if the company is required to prepare a financial report that complies with one or more accounting standards for the financial year during which a dividend is declared or paid under this section - accounting standards in force at the time that a dividend is declared or paid under this section...”

Financial reporting test - ‘look back’ test

The determination of whether a company is required to prepare a financial report is made at the end of a financial year under the s45A large/small test. S45A is a ‘look back’ test because it is based on revenues for the financial year and gross assets at the end of the financial year.

The proposed s254T(1) and (2) tests must be applied immediately before the dividend is declared or paid, which could occur during the financial year. However, proposed s254T(4)(a) requires application of accounting standards to the assets test only if the company is required to prepare a financial report for the financial year during which the dividend is declared/paid. As the determination under s45A of whether a financial report is required will only be made at the end of the financial year, there appears to be a disconnect between the timing in s45A and s254T(4)(a).

This disconnect could result in some companies declaring/paying dividends based on the assets determined using their financial records under the proposed s254T(4)(b) rather than subsection 4(a) in the following circumstances:

- The dividend is declared/paid in the first year that a company trades because the s45A assessment will only be performed at the end of that year (even though such company might be on track to be large by the end of the financial year during which the dividend is declared/paid); and
- The company is a small proprietary company in the financial year before the dividend is declared or paid but may be on track to change to a large proprietary company by the end of the financial year during which the dividend is declared/paid.

Whilst the wording of proposed s254T(4)(a) is clear that the accounting standards to be applied are those in force at the time of declaring/paying the dividend, we recommend that the wording needs to also make clear whether the determination of whether a financial report is required must be made based on the prior financial year, or at the time of declaring/paying the dividend. If the latter was intended we foresee problems because of lack of guidance as to how to apply s45A for a financial year of less than 12 months.

REMUNERATION REPORTS

We have identified several areas in the proposed drafting that require consideration in any final legislation. These include:

- Remuneration governance framework
- Scope of s300A
- Non accounting standard information
- Remuneration outcomes.

These are discussed in more detail below.

Remuneration governance framework

We have identified two issues relating to the corporate governance framework that require attention.

Firstly, proposed s300A(1)(aa)(i) refers to “remuneration governance framework” which does not appear to be defined anywhere, even though it is displayed in bold italic font. We recommend that this term be defined in section 9. We note that the Explanatory Memorandum, paragraph 2.13 identifies possible disclosures that could be included in the description of the remuneration governance framework but no further guidance or definition is included in the proposals.

Secondly, we note that section 308(3C) requires that the remuneration report be audited. Class Order 98/2395 does not permit the transfer of any s300A information out of the directors’ report. Also, s300A(1A) says that the material referred to in s300A(1) must be included in the directors’ report under a heading “Remuneration Report”. It therefore appears inconsistent to permit the information proposed about the remuneration governance framework (proposed section 300A(1)(aa)(i)) to be included elsewhere (i.e. the financial report or another unaudited section of the directors’ report - proposed s300A(1)(aa)(ii)).

Scope of S300A

All companies that are disclosing entities are currently required to prepare a remuneration report under s300A(2), irrespective of whether they are listed or unlisted.

Proposed amendments to s300A(2) mean that in future remuneration reports will only be required for listed companies.

Given s111AE and the automatic inclusion of listed entities as “disclosing entities”, the proposed wording for s300A(2) could be more easily understood as follows: “This section applies to listed companies” which is consistent with the bold heading “Annual directors’ report - specific information to be provided by listed companies” that precedes s300A.

Non accounting standard information

Except for a few disclosures required by s300A that are not required to be measured in accordance with accounting standards, e.g.:

- The value (worked out at the time they are exercised) of options granted as part of remuneration that were exercised during the year - refer s300A(1)(e)(iii)
- The value (worked out at the time the options lapse) of options granted as part of remuneration that lapsed during the year because vesting conditions not met (worked out as if the vesting conditions had been met) - refer s300A(1)(e)(iv) - which is being deleted as part of these proposals,

the majority of remuneration disclosures required by Regulation 2M.3.03(1) must be determined in accordance with accounting standards (refer Regulation 2M.3.03(4)). The addition of the proposed disclosures in s300A(1)(ca) on a cash paid basis may add to the confusion as to the basis for determining different amounts in the remuneration report.

We recommend that s300A(1) include a requirement to clearly distinguish information disclosed on an accrual basis according to accounting standards (Regulation 2M.3.03(1)) from information disclosed on a cash basis (proposed s300A(1)(ca)) or other basis (s300A(1)(e)(iii) and (iv)).

Remuneration outcomes

Proposed section 300A(1)(ca), which deals with remuneration outcomes, refers to “paid to the person”. We can see how cash share appreciation rights would fall into the category of “paid to the person”. However we are unsure whether “paid to the person” only refers to cash amounts paid by the listed company (or its subsidiaries) to the person, or whether it is also intended to include share options granted and exercised that were on sold for cash by the KMP (i.e. realised profits).

Explanatory memorandum, paragraph 2.32 says that listed companies will now report what is realised pay for a KMP. However, we do not believe that the proposed wording specifically covers all realised amounts such as share options exercised and on sold during the year.

Also, realised amounts could comprise other non-cash items such as exercising options that are in-the-money into shares which are not immediately on sold but could be. Are these realised or unrealised amounts?

The intention of proposed s300A(1)(ca) disclosures is not evident from the Explanatory Memorandum. S300A(1)(ca)(i) and (ii) focus on payments during the year, irrespective of when they were granted. We can understand that users would be interested to know the total cash salary received during a particular year, for example, where large bonuses paid relate to a prior year accrual. However, we question the cost involved of extracting ordinary salary package accruals from year to year which s300A(1)(ca)(i) and (iii) appear to require.

Lastly, as mentioned under **Non accounting standard information** above, we are concerned about the potential level of confusion created by including accounting standard and non accounting standard information in the remuneration without reconciliation between the two amounts.