Ernst & Young

Ernst & Young Centre
680 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001

Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
www.ey.com/au

15 March 2013

General Manager
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600
corporations.amendments@treasury.gov.au

Response to Exposure Draft of Corporations Legislation Amendment (Remuneration and Other Measures) Bill 2012

Dear Sir / Madam

Ernst & Young is pleased to submit its comments on the proposed Corporations Legislation Amendment (Remuneration and Other Measures) Bill 2012.

Overall we believe that further changes are required to the proposals before any final legislation is introduced.

Amendments to Dividend Test.
While the proposals introduce some simplification for paying dividends, we feel that the proposed changes haven't gone far enough to address the problems that companies are facing when implementing the current requirements of the Act. In summary these are:

- The proposed changes do not address the interaction of the dividends test with the Corporations Act capital maintenance provisions in Chapter 2J of the Act.
- The views taken by the ATO regarding the treatment of dividends for both tax and franking purposes are disconnected from the views and intention of the changes in the Corporations Act providing little if any real relief for companies. Without addressing the tax consequences there will be no benefit gained from any revisions to the Corporations Act.
- The proposals still rely on a net assets test linked to accounting standards or financial records rather than a pure solvency test.

Amendments to Remuneration Reporting.
While some aspects of the proposals will improve the disclosures, overall we feel that the proposed changes will lead to further confusion amongst shareholders and more time being invested by management and directors without any real benefit.

- Clawback of remuneration: While we support the "if not why not" principle of remuneration clawback disclosure we believe it should be included in the ASX Corporate Governance Principles and Recommendations rather than being legislated.
- Remuneration governance framework: While in principle we support the requirement for companies to disclose their remuneration governance report, we do not believe this should be legislated as

Liability limited by a scheme approved
under Professional Standards Legislation

listed companies are required to comply with the ASX Corporate Governance Principles and Recommendations which includes a principle on remuneration governance (Principles 8). In our view, this additional legislative requirement is not necessary.

- Removing the requirement to disclose the value of lapsed options: We support this proposed change and agree it would enhance remuneration report disclosures.
- Retirement payments: While we support the proposed change, we have made comments in relation to how the disclosure requirement could be improved.
- Past, present and future pay: We do not support the proposed change. This requirement will add another layer of complexity to current remuneration report disclosure requirements and will further confuse shareholders. Instead, we believe "actual" remuneration disclosures should be required and these should replace the current requirement for accounting values to be disclosed. We note the disclosure of "actual" remuneration is consistent with the approach that has been adopted by the UK.

Amendments Remuneration for Certain Statutory Office Holders.
We support these changes for the reasons provided.

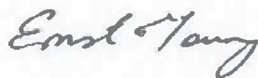
Our detailed comments on each section above are set out in the Appendices 1 and2 to this letter.

We have also attached our submission to the Treasury Discussion Paper ("Proposed amendments to the Corporations Act issued in November 2011) for reference purposes as many of the issues under Appendix 1 have been covered in detail in this submission.

Should you wish to discuss the dividends test issues with us, please contact David Hardidge - Executive Director, Financial Accounting Advisory Services on (07) 3011 3104 / david.hardidge@au.ey.com or Lynda Tomkins - Partner, Australian IFRS Leader on (02) 9276 9605/ lynda.tomkins@au.ey.com

Concerning the remuneration disclosure issues, please contact Mike Hogan, Partner - Human Capital on (02) 8295 6853/ Michael.Hogan@au.ey.com or Joanne Avasti - Executive Director, Human Capital, on (03) 9288 8212 or Joanne.Avasti@au.ey.com.

Yours faithfully



Ernst & Young

APPENDIX 1
Comments on Dividends Test Amendments

While we believe the proposals introduce some simplification for the payment of dividends, we feel that the proposed changes haven't gone far enough to address the some of the practical problems that companies have since the changes were introduced in 2010.

We note firstly issues with the proposals themselves that Treasury will need to address if they proceed with the proposals changes, then discuss further the remaining problems that companies experience which will not be resolved by these proposals. Many of the remaining problems are those which we raised in our response to the consultation paper which is attached in Appendix 3.

1. Proposals to change the timing of the net asset tests

We acknowledge that the government is attempting to reduce the burden on companies by requiring the net assets test to be undertaken only once. However we note a couple of issues in this regard:

- The proposals introduce a test to consider net assets 'immediately' prior to either the declaration or payment date, implying that a second set of financial statements/records will need to be prepared if such dates do not correspond to year end. This will create an extra burden on companies, as certain calculations and activities that are only undertaken at year end, for example impairment, will need to be performed a second time.

- It is unclear for companies that transition from not having to prepare statutory financial reports to having to prepare statutory financial reports how they will comply with dividend test rules (e.g. moving from small proprietary company to large proprietary company). For example, if the company has not completed its first IFRS / accounting standards compliant financial report - does it have to wait until their first report is finalised before paying a dividend, or do they continue to use the financial records as their reference point?

2. Clarification of the interaction between a dividend and a return of capital

The amendments to the Corporations Act 2010 resulted in significant uncertainty and differences of opinion, as to whether a payment is a dividend or a return of capital. Consequently, significant uncertainty exists as to which requirements of the Corporations Act must be followed. The proposed legislation does not make changes to Part 2J or S254T to clarify their interaction.

We believe that without amending S254T or Part 2J to clarify their interaction, diverse views will remain about which part of the Act applies when companies wish to pay dividends to their shareholders. The existence of these diverse views will not help companies.

3. Treatment of dividends for taxation

It is our understanding that the previous "profits test" no longer applies in order for a payment to be considered a dividend for the purposes of the Corporations Act. However, the June 2012 Tax Ruling (TR 2012/5) essentially applies the old "profits test" for tax purposes - both for classification of the receipts by shareholders as an income or capital return, and for whether dividends carry franking credits.

This has been based on a legal opinion obtained by Slater and Hmelnitsky issued at the same time as the ATO Taxation Ruling TR 2012/5. The opinion noted that the 2010 Corporation Act changes, (and therefore the proposed changes), will be ineffective for dividend imputation if a distribution is not made "from profits". As noted below, we believe that a "profits test", either explicitly in legislation (such as the Corporations Act or Income Tax Assessment Act), or implicitly in case law not otherwise overridden by legislation, is no longer appropriate.

Not only does the current uncertainty mean that directors may not be able to determine which requirements of the Corporations Act apply, shareholders may also be adversely affected by later reclassifications of dividends as returns of capital for tax purposes or vice versa, and may be unable to receive franking credits that companies hold.

We believe that without resolving the interaction between the Corporations Act and the tax requirements, the proposed changes will be ineffective in providing greater flexibility for the payment of dividends.

4. Introduction of a solvency test

We recommend that the government expand the net assets test to include valuations, similar to the current New Zealand dividend provisions, as discussed in the Treasury Discussion Paper. Such changes would assist those companies where there is an accretion in value, but the company is unable to show that increase in value in their financial records or financial report because of an effective inability to revalue identifiable intangible assets or unidentified intangible assets. A net asset test that allows for valuation would also assist in addressing the issues noted under item 1 in this appendix.

APPENDIX 2
Comments on Remuneration Reporting

1. Clawback of remuneration

In recent years there has been a raft of legislative and regulatory intervention in Australia and globally. The aims have been to improve the governance of executive remuneration and provide greater transparency to shareholders with respect to the link between executive remuneration and company performance/shareholder value.

Generally we support the requirement for companies to disclose remuneration clawback and we support the "principles approach" to the nature of the disclosure requirement (i.e., disclosure on an "if not why not" basis). However, given the principles based nature of the requirement, in our view, the requirement should be included in the ASX Corporate Governance Principles and Recommendations rather than legislated.

Our view on the current wording of the Exposure Draft are as follows:

1.1 Single event view of clawback

The exposure draft only requires disclosure in a specific event (i.e., a material misstatement or omission over the past three financial statements). There are a range of situations that have the potential to materially impact the financial soundness of the company which would therefore not be required to be disclosed.

This approach therefore enables the board to apply its discretion in relation to how clawback is to be applied based on the needs of the company. We support this approach.

1.2 Coverage of remuneration clawback

We recommend that the clawback disclosure requirement should be clearer in relation to its intended coverage. For instance:

The proposed legislation applies only to current KMP, not previous KMP (i.e., either terminated KMP or current employees no longer classified as KMP). Where a KMP is terminated prior to the material misstatement being discovered, the company will not be required to include this person in the disclosure. We support this approach as there would be a range of practical issues resulting from of clawing back remuneration from departed KMP. .

1.3 Interpretation of materiality

The proposals require disclosure where a material misstatement or omission in the financial statements has occurred in the past three years. Section 9 of the proposals note that the term 'misstatement or error' is determined by reference to the accounting standards, while 'material' is not. A misstatement or omission may be material to a particular line item in the financial statements but may not necessarily result in a material misstatement or omission to the financial statements as a whole. We recommend that further guidance is provided as to how materiality should be considered for this purpose.

1.4 Inconsistency in messaging between the exposure draft and explanatory memorandum

The exposure draft states the requirement to disclose whether details of the clawback of overpaid remuneration that has been, or will be, applied to remuneration "because of the misstatement or omission". The wording in the explanatory memorandum infers a more direct link between the value of

the misstatement and the value of the overpayment by stating "...amounts paid to KMP are often directly linked to figures contained within the financial statements."

We do not consider a direct link to be relevant as this is not necessarily how incentive payments are determined and suggest this is removed or at least, clarified. Payments are often determined from a combination of financial and non-financial outcomes or other related measures such as total shareholder return (relative to a selected group of companies) and may not therefore be based on figures contained within the financial statements. We support the wording in the Exposure Draft and suggest that if an Explanatory Memorandum is to also be released, the wording within the Explanatory Memorandum be amended so as not to infer a link between the financial misstatement and overpaid remuneration.

1.5 Implementation issues likely to be faced by disclosing companies

While the proposed legislation will not require disclosing companies to implement a clawback policy, many companies may elect to do so. Companies seeking to implement a clawback policy in response to the legislation are likely to face the following challenges:

- The company would be have to change and/or renegotiate executive contracts and/or the terms and conditions governing the operation the operation of its incentive plans (to the extent these documents impede the effective implementation of a clawback policy). This will require additional administration and change; and for some companies this could take time to implement.

  Full implementation of the policy (i.e., to enable clawback where a material misstatement has been discovered over the previous three years) is likely to take some time as companies amend incentive plan terms and conditions to include the clawback policy.

- There are likely to be practical difficulties executing clawback where a non-executive KMP is paid as a result of a material misstatement or omission. For example, if a company is trading whilst insolvent, non-executive director fees could be considered "overpaid" remuneration and be subject to the clawback disclosure.

- On the basis clawback is to also apply to non-executive directors, the legislation does not prescribe who is accountable for governing the clawback policy for these individuals. In our view, clawback should be governed by the board and only apply to executive KMP. We suggest the wording of the draft legislation be amended to address this.

2. Disclosure of a general description of the remuneration governance framework

In response to the increased activity in the regulatory and legislative environments over recent years, boards are now taking a more proactive role in relation to the governance of executive remuneration issues - this includes ensuring appropriate governance processes are in place. Remuneration governance is also of increased importance to shareholders given their increased interest and influence over executive remuneration.

We do not support a legislative requirement for companies to disclose the remuneration governance framework as this is an existing requirement for ASX 300 companies which are governed by the ASX Corporate Governance Principles and Recommendations (which, amongst other things, incorporates governance standards relating to "fair and responsible" remuneration structures).

The relationship between the proposed changes and the ASX Corporate Governance Principles and Recommendations is not clear. In our view a legislative requirement to disclose the remuneration governance framework in addition to the ASX Corporate Governance Principles and Recommendations is not necessary and does not provide additional useful information to shareholders.

In our experience, a vast majority of companies already disclose a description of their remuneration governance framework. To legislate would therefore mean companies will be required to add a cross reference to existing information in other areas outside the remuneration report thereby creating confusion around which information is to be audited.

To the extent that the proposed regulations are adopted, our comments in relation to the current wording of the Exposure Draft are:

- Disclosing companies are able to provide a cross reference to other relevant disclosures of the financial report or directors' report. However, a company may include a description of its remuneration governance structure elsewhere in its annual report, such as in its corporate governance statement. Hence the ability to cross reference should be extended to cover any part of the Annual Report and not just the financial report or the directors' report.

- Such a disclosure will be required to be audited as part of the audit of the remuneration report, even where such disclosures are provided outside of the remuneration report or the financial report. We note that this should be confirmed by Treasury in the Explanatory Memorandum.

3. Removing the requirement to disclose the value of lapsed options

The current requirement for companies to disclose the value of lapsed options in the remuneration report offers little utility to shareholders. We support the proposed changes.

4. Disclosure of all payments made to KMP in connection with their retirement from the company

There has been increased public and shareholder scrutiny in relation to termination benefits paid to departing KMP. The proposed legislative change is intended to extend the coverage of the current legislation by also requiring companies to disclose non-contractual payments on termination, as well as an arrangement where a departing director or executive provides consultancy services post termination.

This change follows the 2009 introduction of the Corporations Amendment (Improving Accountability on Termination Payments) Act 2009 which reduced the limit of a termination payment that can be made to a KMP without shareholder approval (limited to one times base salary).

We support the requirement for companies to disclose non-contractual termination payments to departing KMP and details of arrangements to be entered into, as this will provide greater transparency to shareholders in relation to termination payments. We do however have the following comments:

- The Bill specifically refers to "retirement", which captures a limited number of termination scenarios (i.e., loss of, resignation from the office or position and death of a person at a time they hold the office or position). There are other potential termination scenarios (such as the expiry of a contract). The legislation should require disclosure of non-contractual payments to also be made in these circumstances.

- It is unclear in the proposals whether disclosure of such benefits would be required at the time they are granted or at the time they are paid. For the purposes of providing adequate accountability, we believe the former should apply. However this issue arises from the fact that the proposals in sub paragraph 300A(1)(ea) refer to "benefits to be given" while the Explanatory Memorandum refers to

"benefits that are given" and also refers to the definition of "benefit" is as per s200A(b) - which deems that benefits are given when the "payment is made or property transferred".

- There is therefore a risk that, due to the lack of clarity in the wording of the legislation, disclosure may not be provided if the payment is made subsequent to the reporting year if the s200AJ definition is applied. We recommend that the Explanatory Memorandum be revised to specify the timing of the required disclosure.

- The examples provided in the Explanatory Memorandum of the types of benefits should also cover unvested shares, options or performance rights which the terminated KMP may be entitled to retain post employment - together with guidance on how the value of such benefits (i.e., "valuable consideration" should be determined). Given the difficulty in determining the value to be received by the KMP, we recommend the number of instruments and any exercise price payable be disclosed instead.

- The proposed wording specifies benefits to be given by the company or "a related body corporate". This term is not the same as the term "related party" and hence there is a potential that non-contractual termination payments made by a related party (that is not a "related body corporate") would be excluded from the disclosure requirements. We recommend the term "related body corporate" be replaced with the term "related party".

5. Disclosure of past, present and future pay

In our submission to CAMAC on 13 August 2010, we identified a range of factors impeding the effectiveness of the current remuneration reporting framework. A key area we raised is the common misinterpretation of disclosures arising due to the requirement to disclose accounting values, which reflect the accounting expense to the company, rather than the value earned and delivered to the executive.

To address this issue, we suggested companies be required to disclose actual levels of remuneration received by executives (rather than accounting values as per the current disclosure requirements). This view is consistent with the views expressed by the Productivity Commission (PC) and is consistent with the approach adopted in the UK.

In our submission, we also provided guidance on the basis that actual remuneration should be valued and disclosed to ensure relevance and meaningfulness to shareholders and comparability from company to company.

In general, we do not support the proposal to disclose past, present and future pay. In our view, the requirement for companies to disclose "actual" remuneration would be more effective in enhancing remuneration report disclosures and should replace the current requirement for accounting values to be disclosed.

Our recommendations in relation to how remuneration should be disclosed were expressed in our submission to CAMAC. The key differences between our recommendation and the Exposure Draft are as follows:

- **Past pay:** In our submission to CAMAC, past pay would be disclosed in the "cash incentives" and "share-based payments" sections which would specify which payments relate to a 12-month performance period versus a period greater than 12-months. Additionally, we specify that the value of share-based payments should reflect the cash gain available to executives (rather than accounting values).