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Ref: DAH

15 March 2013

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

By email: corporations.amendments@treasury.gov.au

Dear Sir/Madam

CORPORATIONS AMENDMENTS - IMPROVING DISCLOSURE REQUIREMENTS

We appreciate the opportunity to provide our comments on this proposed legislation. Pitcher Partners is an association of independent firms operating from all major cities in Australia. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities and small to medium sized enterprises.

Key executive remuneration measures – general comments

The disclosures for key executive remuneration are already extensive. In our view, the existing disclosure requirements do little to aid user understanding due to "information overload". The proposed "reforms" further aggravate this problem, without adding clarity, when clarity is urgently needed.

Further, we have concerns that the proposed legislation is seeking to address every possible adverse situation and explicitly state the disclosures required. In worst case scenarios if limited or insufficient disclosures are provided, shareholders have the opportunity to question directors on the company's remuneration practices and to vote against the remuneration report. Consequently we do not support inclusion of additional disclosure requirements that may only serve to overcomplicate remuneration disclosures, while adding little value.

Disclosures relating to clawback of overpaid remuneration

We consider that this requirement is given undue prominence and emphasis, and relates to an unusual and relatively rare situation. Further we consider that the context for this proposed requirement as explained in paragraph 3.10 of the Explanatory Memorandum undermines the audit process.

Paragraph 3.10 of the Explanatory Memorandum states: "The introduction of a requirement to disclose a company's clawback policy may deter KMPs from intentionally misstating a company's financial statements to boost performance-based remuneration as the board is likely to clawback any excess remuneration as a result of the misstatement."

This behaviour describes financial fraud and is already addressed in Australian Auditing Standards ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report.* In particular ASA 240 paragraph 3 describes the characteristics of fraud and ASA 240 paragraph A1 alerts the auditor to situations where there is an incentive, a perceived opportunity and the ability to rationalise behaviours. ASA 240 paragraph A2 specifically identifies a fraud risk when there is a desire to maximise compensation where management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial report.

Consequently, we would anticipate that any material misstatements that are discovered in a subsequent year are likely to be genuine errors based on "best-estimates", which have come to light when more information concerning facts and circumstances surrounding the issue are subsequently discovered and the estimate is revised.

If unusual and rare situations which result in lower reported earnings need to be addressed explicitly in the Act, then in addition to material misstatement, previously reported company performance might change dramatically due to a change in the basis for preparing critical accounting estimates and judgments, or through the application of a different accounting policy, which is deemed to provide improved financial information. However, these matters are not addressed and may also contribute to performance-based payments being over-estimated.

We consider that any changes to remuneration arising through changes in *the reported* company performance are adequately, although not explicitly, covered under the existing related disclosures in section 300A of the *Corporations Act 2001* and *Corporations Regulations 2001.* In a worst case scenario if limited or insufficient disclosures are provided, shareholders have the opportunity to question directors on the company's remuneration practices and to vote against the remuneration report. Consequently we do not support inclusion of this item as it may only serve to overcomplicate remuneration disclosures, while adding little value.

Remuneration governance framework

The proposal to include a general description of the "*remuneration governance framework*" introduces a new term which has not previously been used. Yet, in substance the information that is disclosed under current requirements comprise components of a remuneration governance framework.

For example the *Corporations Act 2001* Section 300A includes requirements to disclose:

- A remuneration policy;
- The relationship of remuneration to company performance;
- Various matters relating to consultation with a remuneration consultant;
- Matters arising from the AGM in relation to executive remuneration

In addition the *Corporations Regulations 2001* require disclosures regarding:

- The descriptions of those who are key management personnel;
- The nature of remuneration payments made and the remuneration structure and any changes thereto;

Finally, the ASX Principle 8: *Remunerate fairly and responsibly* include similar disclosures.

Disclosure of the number rather than the value of lapsed options
We consider that the *value* of lapsed options, previously shown as share-based payments in remuneration to KMP, is relevant in explaining to shareholders, how much remunerations was *not* actually transferred to KMP. Consequently, we consider that this concession is of little benefit to readers of the remuneration report.

Disclosure of amounts paid before, during and after the financial year
Australian Accounting Standard AASB 124 *Related Party Disclosures* includes a definition for *compensation* in paragraph 9 which includes the statement "…*Employee benefits are all forms of compensation paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity*…"

In respect of disclosures provided in the Remuneration Report in accordance with subregulation (1) of Regulation 2M.3.03 Prescribed Details (Section 300A), subregulation (4) requires that "… a company must apply the requirements of relevant accounting standards when disclosing the information mentioned in the subregulation."

Further subregulation (5) states:

(5) In subregulation (1), an expression that is:
- a) used in the subregulation; and
- b) defined in a relevant accounting standard that is applied for the purpose of disclosing information;

has the meaning given by that accounting standard.

We consider that disclosure of amounts due in respect of services provided for the financial year under existing requirements is most appropriate, and the timing of that payment has little relevance. This is particular true for non-cash components of remuneration as a decision to make such a payment might be agreed in substance ahead of the time when (eg) a share-based payment is formally agreed and/or granted to KMP. We consider that the proposed disclosure is onerous and will provide minimal additional information of value to readers of the Remuneration Report.

Disclosures relating to composition of the remuneration committee
We consider that adequate disclosures are already made under the ASX *Corporate Governance Principles*.

Additional disclosures relating to termination benefits
We consider that the existing disclosure requirements are adequate.

Relief to unlisted disclosing entities from obligation to prepare a remuneration report
We concur with the proposal to relieve unlisted disclosing companies from the obligation to prepare a remuneration report. We consider that disclosures required under AASB 124 *Related Party Transactions* in respect of KMP remuneration are appropriate for these entities.

Amendments in respect of dividend payments
The proposals do not address the problems sufficiently in relation to dividends payments. The requirement to apply the dividend test at the time of proposing a dividend and at the time of payment, is consistent with current practice. However the proposals do not alleviate the cumbersome nature of the dividend test, when in substance the test should be concerned primarily with solvency.

Lack of alignment with Taxation Laws and principles of capital maintenance
The lack of alignment with Taxation Laws (and vice versa) and principles of capital maintenance remains problematic and has not been addressed, even though it is the key issue adversely impacting application of the current law.

These issues in respect of dividend payments and interaction with the Taxation Laws need urgent attention to make the legislation more practicable. In certain circumstances the lack of clarity continues to require extensive consultation and legal opinions to support action taken by management.

We concur with the proposal, where a company is not required to apply accounting standards, to permit a company to calculate assets and liabilities by reference to the company's financial records. However, solvency should remain a primary consideration.

Relieving public companies from obligation to appoint an auditor if an audit is not required
We consider that the relief proposed is appropriate. However, it does not address situations where a company limited by guarantee has revenues which fluctuate from year to year either side of the $1 million annual revenue threshold, in respect of auditor resignations and (re)appointments.

Please do not hesitate to contact us if there are any matters arising from this submission which you would like to discuss further.

Yours faithfully
PITCHER PARTNERS

S D AZOOR HUGHES
Partner