CHAPTER 14

DIRECTORS' REMUNERATION

Whether listed companies' annual reports should include further and more detailed particulars relating to the remuneration of directors and executive officers

14.1 New section 300A of the Corporations Law, inserted by the *Company Law Review Act 1998*, requires listed companies to include in the annual directors' report for the financial year further material than previously required to be disclosed about the remuneration of directors and executive officers. The requirement applies to listed companies reporting for financial years ending on or after 1 July 1998.

14.2 Specifically, the new section requires disclosure under three categories:

(a) discussion of broad policy for determining the nature and amount of emoluments of board members and senior executives of the company;

(b) discussion of the relationship between such policy and the company's performance; and

(c) details of the nature and amount of each element of the emolument of each director and each of the 5 named officers of the company receiving the highest emolument.

14.3 The requirement for the disclosure of information applies to companies that are incorporated in Australia and included in an official list of the Australian Stock Exchange (ASX). It also applies despite anything in the company's constitution.[1]

14.4 Section 300(1) (d)of the Corporations Law also requires the directors' annual report to disclose details of options that are:

(i) granted over unissued shares or unissued interests during or since the end of the year; and

(ii) granted to any of the directors or any of the 5 most highly remunerated officers of the company; and

(iii) granted to them as part of their remuneration;

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1 Sections 300A(2) and 300A(3) of the *Company Law Review Act 1998*.

14.5 A large number of submissions supported either in whole or in part further disclosure relating to the remuneration of directors and executive officers. However, it should be noted that the disclosure requirements under paragraphs (a) and (b) of section 300A received considerably more support than paragraph (c). Several organisations, companies, professional bodies, and individuals who supported the disclosure of remuneration policies and discussion of the linkage between remuneration and a company's performance, opposed the disclosure of the amounts received by directors and senior executives by name in the annual report.[2]

Arguments in favour of the new disclosure requirements in paragraphs (a), (b), and (c)

Capping senior executive remuneration

14.2 The Australian Investors Association Ltd (AIA) supported the new disclosure requirements to the extent that these were not inconsistent with the AIA/ASA policy statement on limiting chief executive salaries. The AIA policy favours full disclosure of the total remuneration package for each director and the five highest paid executive officers. The policy also comments on the actual levels of executive remuneration claiming that a salary of $3million per annum is excessive for the chief executive of any Australian company. The annual salary component of the chief executive's remuneration package should be less than $2m with the balance being made up of options. According to the AIA, the price and exercise rights of options should "link the fortunes of the CEO with those of the shareholders and executive options should be issued in accordance with the AIA/ASA policy."[3]

Disclosure of directors' remuneration is in the interests of good corporate governance

14.3 The Investment & Financial Services Association Ltd (IFSA) supported the disclosure requirements on the basis that disclosure of directors' remuneration is an established aspect of international best practice in corporate governance:

> It derives from the fundamental concept that company management and board are the agents of the investors who own the company and are selected to plan and run the company for their owner principals. In order for those principals to assess the performance of their agents and, in particular, to evaluate the cost of the agents to the owners vis-

2 See for example, Association of Mining and Exploration Companies Inc, Submission 45, p 4; GIO Australia Holdings Ltd, Submission 29, p 3; Chartered Institute of Company Secretaries, Victoria Branch, Submission 24, p 4 and Arnold Bloch Leibler, Submission 23, pp 10-11.

3 Australian Investors Association Ltd, Submission 25. See attached AIA policy statement, p 19.

> a-vis the contribution of those agents to improving the value of the owners' investment, it is necessary for the owners to know the various components of that cost. These components include all forms of monetary remuneration and, if applicable, equity dilution through share or option schemes.[4]

14.4 IFSA noted that a disclosure regime has found favour in the US and the UK. In the US, the Securities and Exchange Commission requires the company's remuneration committee to report annually to shareholders on the company's remuneration policy and to disclose by name the company's chief executive and the 4 most highly compensated executives together with the disclosure in tabular form of all amounts received by each officer. In the UK, the Code of Best Practice on remuneration, based on the Greenbury Committee Report on Directors' Remuneration is mandated under the London Stock Exchange Listing Rules for UK companies listed on that exchange.[5] A similar trend was developing in Australia and IFSA referred to Guideline 10 of its Guide for Investment Managers and Corporations. The Guideline contains a recommendation that companies disclose in their annual reports the "policies on and quantum and components of remuneration for all directors and each of the 5 highest paid executives. The disclosure should be made in one section of the annual report in tabular form with appropriate explanatory notes".[6]

14.5 It was claimed that this kind of disclosure promoted accountability and fairness. In addition, it provided shareholders with information about the quantum and components of the remuneration package for comparison against the company's performance and the stated polices of the board. IFSA submitted a paper it commissioned on the level of disclosure of directors' remuneration by Australian companies to the PJSC for its consideration. The paper authored by Ms Jennifer Hill, Associate Professor at the University of Sydney Law School reviewed the disclosure arrangements at the time.[7] It found that the disclosure requirements were outdated and did not "provide information on a

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4 Investment & Financial Services Association Ltd, Submission 34, p 10.

5 Investment & Financial Services Association Ltd, Submission 34, pp 10-11. This Code was replaced in June 1998 by The Combined Code based on the recommendations of the UK Hampel Committee on Corporate Governance. The disclosure of directors' remuneration is mandated under Article B.3 "Disclosure" which states "The company's annual report should contain a statement of remuneration policy and details of the remuneration of each director". Article B.3.1 of The Combined Code also provides that "The Board should report to the shareholders each year on remuneration. The report should form part of, or be annexed to, the company's annual report and accounts."

6 Investment & Financial Services Association Ltd, Submission 34, p 10. See also *Corporate Governance: A Guide for Investment Managers and Corporations*, July 1999, 12.11.

7 Ms Jennifer Hill, *Remuneration Disclosure for Directors & Executives in Australia*, Investment & Financial Services Association Ltd, February 1996.

number of important matters, such as the composition of remuneration and value of shares and options used as incentive remuneration".[8]

Current disclosure arrangements inadequate

14.6 The Group of 100 Inc contended that the previous provisions for disclosure relating to remuneration were inadequate and that shareholders have a legitimate interest in this information:

> The Group of 100 considers that the present requirements included in AASB 1017 "Related Party Transactions" and AASB 1034 "Disclosure of Information in Financial Reports" do not provide useful information to users because it is not clear what purpose the disclosures are intended to serve. We believe that the shareholders in a company have a legitimate concern and, consistent with current community expectations regarding corporate governance, are entitled to expect information about the remuneration of directors and senior executives.[9]

14.7 The Group of 100 supported the principle of disclosure but submitted that the inclusion of the new requirements without a due process was inappropriate.

Difficulty in valuing share option schemes

14.8 The Accounting Association of Australia and New Zealand (AAANZ) supported more extensive disclosure of directors' remuneration and attributed the past less-than-full disclosure to the inability of directors to value financial instruments such as share options. The AAANZ submitted that a requirement to disclose and discuss remuneration policies would prompt company boards to consider more effectively the issues underlying their executive remuneration decisions:

> There should be a requirement that companies disclose either the fair value of share options (and any other derivative instrument that forms part of the executives' remuneration packages), or else disclose enough information to enable a professionally qualified analyst to place a sufficiently precise value on them. These valuations would need to reflect … the factors that make executive share options less valuable than call options traded in public markets.[10]

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8 Ms Jennifer Hill, *Remuneration Disclosure for Directors & Executives in Australia*, Investment & Financial Services Association Ltd, February 1996, p 27.

9 Group of 100 Inc, Submission 15, p 1.

10 Accounting Association of Australia and New Zealand, Submission 16, pp 2-3.

14.9 The AAANZ noted that Accounting Standard AASB 1033 "Presentation and Disclosure of Financial Instruments" already requires disclosure of the net fair value of financial instruments. It argued that difficulties in valuing executive share options should not prevent disclosure of their fair value. Further, a statement of the board's remuneration policy would "assist shareholders to understand better how they can gain from a closer alignment of their interests with those of the executives, as can be achieved by the use of share option plans."[11]

14.10 Similarly, IFSA noted that the use of shares and share option schemes as part of the remuneration package should align the interests of executives with those of shareholders "through direct equity participation in the future of the company". In addition, the disclosure of these financial instruments was essential because:

> … shareholders need adequate disclosure to ensure that they are receiving due reward for the dilution that equity participation entails. Present and past practice has seen these schemes used in a variety of ways and shareholders need to be given the information to enable them to understand the policy objective of these schemes.[12]

Disclosure requirement will show who are the key decision-makers

14.11 According to RewardSolve Consulting Pty Ltd (RewardSolve), the new disclosure requirement will establish "an unequivocal standard for disclosing director and senior executive remuneration". Previously the disclosure regime could result in misleading information being disclosed as companies could decide who is reported or not reported. In particular, the requirement to disclose the remuneration of managers who earn in excess of the $100,000 threshold may not identify the key decision makers in the company:

> In many organisations senior professional or technical staff (who do not have a direct impact on setting the company's direction or affecting the bottom line performance) may still be covered by awards, can fall into the $100,000 plus net when the full value of their remuneration is calculated. Given that scenario, I believe that one unintended consequence is that who is actually disclosed in the annual report becomes a highly discretionary activity by the company. Companies make their own interpretation of who is to be disclosed and therefore this is not consistent across all companies.[13]

14.12 RewardSolve supported the introduction of uniform disclosure requirements to ensure consistency of reporting across all companies but

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11 Accounting Association of Australia and New Zealand, Submission 16, pp 2-3.

12 Investment & Financial Services Association Ltd, Submission 34, p 11.

13 RewardSolve, Submission 32, p 2.

recommended that disclosure should be required from two levels of management below the chief executive or managing director:

> Disclosure of remuneration from these top two levels and the CEO/MD will capture the strategic management ranks…It is well known that anyone who is really going to make an impact on the direction and performance of a company will come out of these two top levels of management.[14]

Public interest outweighs privacy considerations

14.13 The principal argument against the disclosure requirement in paragraph (c) of section 300A is that the naming of directors or senior executives is an invasion of privacy (see below at paragraphs 14.31 to 14.35). The Australian Law Reform Commission (ALRC) supported full disclosure noting that the distinction between public office holders and senior executives of publicly owned companies was no longer relevant:

> Although disclosure in some cases might be seen by some to involve an invasion of privacy, the increasing diversity of ownership of listed companies, together with ongoing corporatisation and listing of major government enterprises, suggests that former privacy distinctions between senior public office holders and senior officers of publicly owned and listed companies no longer have any real substance, particularly when considered against the public interest in full disclosure to investors.[15]

14.14 Similarly, the West Australia Joint Legislative Review Committee of the Australian Society of Certified Practising Accountants, the Institute of Chartered Accountants in Australia and the Chartered Institute of Company Secretaries supported the disclosure requirement on the basis that it conforms with disclosure requirements in other countries such the US and the UK. The Review Committee submitted that members have a right to know whether they are receiving 'fair value for money'. In regard to the privacy issue, the Review Committee noted:

> We do not accept the argument put by some that this disclosure will expose the recipients of the emoluments to terrorist attack. There is no evidence, of which we are aware, that links such financial reporting with terrorism. Also, any director is entitled under

14 RewardSolve, Submission 32, p 2.

15 Australian Law Reform Commission, Submission 10, p 6.

> s.242AA(2) to have their residential address withheld from the register if they have done the same under the *Electoral Act 1918.*[16]

Suggested amendments to section 300A

14.15 Arthur Anderson supported the new disclosure requirements in principle but recommended amending section 300A so that there is consistency between the executives included in the banded information required under the Accounting Standard AASB 1034 and the disclosures required under section 300A. Arthur Anderson advised that AASB 1034 requires banded disclosures of executive officers of 'entities' controlled by the company whose remuneration is $100,000 per annum or more but excluding amounts paid where the executive officer worked wholly or mainly overseas. However, section 300A requires the disclosure in respect of the directors and executive officers of the 'company'. Arthur Anderson advised that the inconsistency is significant because the highest paid executives in an 'entity' are not always employees of the listed parent 'company':

> Thus where a listed company is a controlling entity the five highest paid executives covered by the new director's report disclosure requirements may not be necessarily the five highest paid executives included in the AASB 1034 banded disclosures.[17]

14.16 Freehill Hollingdale and Page advised that the disclosure requirements have created a degree of uncertainty because of the inconsistency between the Law and the relevant accounting standards, and recommended the following amendments:

- Where disclosures are required in the directors' report under section 300(2) they need not be included in that report where the details are contained elsewhere in the company's annual financial report. This should apply to disclosures under section 300A so that the disclosures about the 5 highest paid executive officers will appear in the same note as the 'bands' disclosure of income of all executives;

- The word 'emoluments' should be changed to 'remuneration' of each director and officer, adopting the definition used in Accounting Standards AASB 1017 and AASB 1034 for the disclosure of remuneration of directors and executive officers in "bands";

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16 West Australia Joint Legislative Review Committee of the Australian Society of CPA, the Institute of Chartered Accountants and the Chartered Institute of Company Secretaries, Submission 18, p 5.

17 Arthur Anderson, Submission 22, p 2.

- The requirement should be to disclose details of the "5 named officers receiving the highest income" as required by AASB 1034, so that there is consistency throughout the reporting requirements.[18]

Duplication of accounting standards

14.17 While supporting more extensive disclosure of the remuneration of directors and executive officers, a number of submissions argued that it was more appropriate for this requirement to be dealt with by the relevant accounting standards.[19] It was stated that the Law merely duplicated the disclosures already required in Accounting Standards AASB 1017 and AASB 1034 and the lack of clarity in the drafting of section 300A contributed to uncertainty about the reporting requirement. The PJSC was also told that the inclusion of new section 300A was contrary to the objective of the Company Law Review Act, which is to remove detailed accounting requirements from the Law. Ernst & Young submitted that:

> The inclusion of such requirements in the Accounting Standards in preference to the Law would mean that the disclosures would be made in the notes to the financial statements and not in the Directors' report. The notes to the financial statements are subject to the auditor's report, whereas the Directors' report is not. This means that information in the Directors' Report is subject to a lower level of independent assurance than is information in the notes to the financial statements.[20]

14.18 The Accounting Bodies expressed support for the disclosure requirements and advised the PJSC that the Australian Accounting Standards Board (AASB) has undertaken to revise the related party disclosure standard and the financial reporting standard to reflect the provisions in new section 300A.[21] The Accounting Bodies emphasised that the new accounting standard will also conform with international accounting standards:

> **Mr Parker**-There are two accounting standards that deal with the issue of related parties and executive remuneration: AASB I017 deals with the disclosure of related party relationships; AASB I034, disclosure of financial information, deals with the disclosure, amongst other things, of executive remuneration. The related party standard deals with disclosure of directors' remuneration. Basically, these standards in part apply what was previously in schedule 7 of the Corporations Law, so that has been picked up and put in an

18 Freehill Hollingdale and Page, Submission 42, pp 1-3.

19 See for example Securities Institute, Submission 75, p 1.

20 Ernst & Young, Submission 31, p 1.

21 Joint Submission by the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, Submission 73, p 6.

accounting standard, AASB I034. Those accounting standards are shortly going to be revised to have an exposure draft out on directors' and executives' remuneration based upon the changes made to the Corporations Law. So what the accounting standard is doing is implementing the requirements of the Corporations Law.

What we are concerned about is that the requirements of the Corporations Law itself might conflict with what the standard setters consider to be an ideal standard. For example, you might use terminology in the Corporations Law that would not be used in the accounting standard. What we would like to see is the board develop an accounting standard on directors' and executives' remuneration. And if the board feels-the board being the AASB-that there are changes necessary to the Corporations Law, because the board cannot issue a standard in conflict with the Corporations Law, then the law would be amended so that we do have a top quality accounting standard on this issue.

CHAIR-So the accounting standard requires the disclosure of individual remuneration, or is it still the old provision?

Mr Parker-It is still the old provision.

CHAIR-For bands of remuneration?

Mr Parker-Yes.

CHAIR-So the law now goes further than that?

Mr Parker-Yes, it does. The standard setters want to, if you like, flesh out what the requirements of the law are in an accounting standard.

CHAIR-Our purpose is to review the law as it stands, particularly some of the amendments that were not in the original drafted legislation. What is the view of the accounting bodies with regard to that more stringent requirement for disclosure?

Mr Meade-I think the accounting bodies would certainly support the more stringent requirements. Once again, that is bringing it into line as well with requirements in major overseas jurisdictions, where disclosure is required by an individual director and disclosure is required of the senior executives in an organisation. We would support that. As I mentioned in the opening address, the unfortunate thing is that we need to clarify some of the matters which remain uncertain and unclear as a result of the wording contained in the law as it currently stands. We would certainly hope that those matters would be able to be resolved, certainly when the accounting standards are revised on this particular matter.[22]

22 Mr Colin Parker, Committee Hansard, 16 June 1999, pp 28-29.

Monitoring of compliance

14.19 In November 1998, the Australian Securities and Investment Commission (ASIC) released Practice Note 68 to give some guidance on the application of new section 300A. The ASIC Note states that its policies are to be taken as 'interim guidance' while this area of the Law is reviewed by the PJSC. The ASIC also undertook a survey of annual reports with balancing dates from 1 July to 31 December 1998 to assess the extent of compliance with the Law. Almost all the companies surveyed complied with the new requirements, although there were a number of cases where the value of options granted to directors and officers were not included in emoluments.[23]

14.20 At its hearing in Sydney on 17 August 1999, Ms Jillian Segal, a Commissioner of the ASIC, told the PJSC that compliance with the disclosure requirements was "very good" with the exception of the disclosure of the valuation of options.[24] The reason for this was that companies did not necessarily agree with the ASIC policy as stated in the Practice Note that the Law required disclosure of the valuation of options as part of the emoluments.[25] Ms Segal advised the PJSC that the ASIC would continue to monitor compliance with section 300A in the next reporting period and would enforce disclosure of a value for options granted.[26]

Unintended consequence

14.21 The PJSC was told that the disclosure requirement in paragraph (c) of section 300A could be problematic for companies with highly paid technical staff who are not executive officers or for companies with a small workforce. Paragraph (c) requires the disclosure of the remuneration of "each of the 5 named officers of the company receiving the highest emolument". The PJSC was told that exploration companies routinely remunerate senior geologists at different levels based on various performance factors. As one of the 5 company officers receiving the highest income, the geologists' salary would need to be included in the disclosure even though they may not have participated in the management of the company. The Association of Mining and Exploration Companies Inc (AMEC) argued that in the case of exploration companies that are yet to generate income the requirement "is unsuitable and could be inadvertently misconstrued by members of the public unfamiliar with the operation of an exploration company."[27] The public disclosure of the salaries of

23 See ASIC Media Release 99/220, *Surveillance of Company Financial Reports*, 1 July 1999.

24 Ms Jillian Segal, Committee Hansard, 17 August 1999, p 212.

25 Mr Douglas Niven, Committee Hansard, 17 August 1999, p 215-16.

26 Ms Jillian Segal, Committee Hansard, 17 August 1999, p 216.

27 Association of Mining and Exploration Companies Inc, Submission 45, p 4.

company staff also has the potential to cause significant organisational difficulties.

14.22 The Australian Institute of Company Directors (AICD) submitted that the disclosure requirement could result in the salaries of non-managerial staff being disclosed.[28] This would be problematic even on a small scale as some junior exploration companies employed only a handful of permanent staff. As Mr Laurie Factor, Senior Lecturer at the School of Business Law, Curtin University explained to the PJSC:

> We have a great number of small junior explorers, some of which actually do not even run to five employees. I know that might seem strange, but everyone is on contract drilling holes out in wherever, and back here in town we have got the standard three directors. Quite often they are executives of the company as well-geologists, whatever. Maybe there is one that is independent. And they might have an office manager and a receptionist. That receptionist is going to actually figure in the top five, because the way it is drafted it says 'officers'. That attracts the definition in 82A, which includes employees. It needs at minimum to be given the term 'executive officer' and put into that category within section 9, an executive officer being someone involved in the management of the company.[29]

Listed managed investment schemes

14.23 Several submissions pointed out that section 300A only applies to a company that is incorporated in Australia and is included in an official list of the ASX.[30] As a consequence registered managed investment schemes which are listed such as listed trusts are not required to make the disclosure in their annual directors' report. Ernst & Young noted the inconsistency in reporting requirements "despite the general applicability of other directors' report disclosure requirements to registered schemes. It is uncertain whether the omission of listed registered schemes was intentional as there does not appear to be a strong reason for this distinction from the disclosure requirements of listed companies."[31] The ASX submitted that "if disclosure of directors' remuneration is accepted as desirable, it is not clear to us why it is limited to listed entities."[32]

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28 Australian Institute of Company Directors, Submission 47, pp 7-8. See also KPMG, Submission 71, p 5.

29 Mr Laurie Factor, Committee Hansard, 16 August 1999, pp 129-30.

30 See for example, Ernst & Young, Submission 31, p 2.

31 Ernst & Young, Submission 31, p 2.

32 Australian Stock Exchange, Submission 44, p 11.

Arguments against the new disclosure requirements in paragraphs (a), (b), and (c)

Current disclosure arrangements are adequate

14.24 A number of submissions stated that the new disclosure requirement was unnecessary because the disclosure arrangements prior to the enactment of section 300A were adequate. Allen Allen & Hemsley submitted that the previous requirements concerning remuneration required companies to report the number of officers of the company receiving remuneration in specified "bands". This information was more than adequate to enable shareholders to assess whether senior officers were paid an appropriate level of remuneration to senior officers.[33] In addition, shareholders of listed companies already have the power under the ASX Listing Rules to approve the aggregate remuneration payable to non-executive directors of the company:

> Those directors must be paid within the aggregate limit fixed by shareholders. Beyond that, shareholders have no power to fix the remuneration payable to individual non-executive directors and the disclosure of the manner in which the aggregate amount is divided amongst non-executive directors serves no useful purpose.[34]

14.25 Suncorp-Metway Ltd argued that there is already sufficient disclosure to enable the financial impact of remuneration payments to be ascertained by shareholders.[35] Similarly, Bristile Ltd noted that current requirements are adequate as they ensure that the community and shareholders are aware of the value of the total remuneration being earned by a listed company's executives.[36]

Arguments against the disclosure required under paragraph (a) and (b)

14.26 The AICD opposed the inclusion of a statement which discussed board policy for determining remuneration as this kind of statement was already required under ASX Listing Rule 4.10.3 and paragraph 5 of Appendix 4A. Although the AICD described the requirement in paragraph (a) of section 300A as "straight forward", the requirement would only produce general statements. A more useful disclosure would be a discussion of how remuneration is structured to encourage performance maximisation for the benefit of shareholders.[37] The AICD listed the reasons for its opposition to the

33 Allen Allen & Hemsley, Submission 9, p 4. See also National Can Industries Ltd, Submission 49, p 2 and Boral Ltd, Submission 14, p 2.

34 Allen Allen & Hemsley, Submission 9, p 4.

35 Suncorp-Metway Ltd, Submission 17, p 2.

36 Bristile Ltd, Submission 26, p 2.

37 Australian Institute of Company Directors, Submission 47, p 6.

requirement for a discussion of the relationship between the board's remuneration policy and the performance of the company, noting that a company's performance may be affected by factors outside directors' control.[38]

Arguments against disclosure by name of remuneration of directors and executive officers

Invasion of privacy

14.27 The most frequent objection to the disclosure of remuneration details required by section 300A and the naming of individual executives is that such disclosure constitutes an invasion of privacy of the individuals concerned.[39] The following objections were made to the disclosure requirement:

- The details to be disclosed are not material to investors and reveals private matters for those concerned;[40]
- The disclosure of this information serves no useful purpose but to satisfy the prurient curiosity of certain sections of the business community and the investing public;[41]
- The naming of executives is an invasion of privacy and may expose the named officers to extortion attempts and other criminal acts;[42]

14.28 According to Arnold Bloch Leibler, the disclosure conflicts with some well established privacy principles:

> The requirement to disclose emoluments would conflict with a number of the privacy principles which are enshrined in the National Principles for the Fair Handling of Personal Information issued by the Federal Privacy Commissioner in February 1998 and which are proposed to be included in the Data Protection Bill which the Victorian Government intends to introduce later in the year.[43]

14.29 Arnold Bloch Leibler suggested that an alternative to the disclosure by name of the company's five most highly remunerated officers would be to have the discussion of the board's policy included in the annual report without the disclosure of the precise amounts and the names of individual officers. This compromise would enable shareholders to continue to have information

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38 Australian Institute of Company Directors, Submission 47, pp 6-7.

39 See for example Boral Ltd, Submission 14, p 2. See also Australian Institute of Company Directors, Submission 47, p 8 and National Can Industries Ltd, Submission 49, p 2.

40 Porter Western Ltd, Submission 2, p 1.

41 Allen Allen & Hemsley, Submission 9, p 4.

42 Suncorp-Metway Ltd, Submission 17, p 2.

43 Arnold Bloch Leibler, Submission 23, p 10.

regarding changes in emoluments by segments, representing threshold remuneration levels without the need for the names of officers to be disclosed.[44]

14.30 Freehill Hollingdale and Page submitted that the previous "band" disclosures provided sufficient disclosure for corporate regulation purposes, whereas the new requirement ignores the privacy of an individual's financial affairs:

> We suggest that there is no additional corporate governance benefit to shareholders in knowing precisely which director or officer is receiving which remuneration. The requirement that emoluments be disclosed in a public document in the manner contemplated by the recent amendments does not pay due regard to the interests of the persons concerned in having their financial details kept private.[45]

14.31 AMEC advised that the requirement constitutes an invasion of privacy particularly as it relates to the naming of individuals who are not directors:

> Given their role as directors of listed companies, company directors accept the need to make public details of their remuneration packages. The same treatment should not apply to non-directors whose role within a company does not demand the same level of public scrutiny.[46]

Drafting of section 300A is unclear

14.32 Several submissions told the PJSC that the drafting of section 300A failed to take account of words and phrases used in provisions in the Law and the accounting standards.[47] Ernst & Young noted the following uncertainties and deficiencies in section 300A:

- The meaning of 'emolument' is uncertain given the use of the more common word 'remuneration' in the accounting standards AASB 1017 and AASB 1034. Discrepancies may arise in reporting as a consequence of these different terms which have different meanings;
- It is uncertain as to whether the term 'emolument' can be applied to non-directors;

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44 Arnold Bloch Leibler, Submission 23, p 11.

45 Freehill Hollingdale and Page, Submission 40, p 5.

46 Association of Mining and Exploration Companies Inc, Submission 45, p 4. See also Bristile Ltd, Submission 14, p 2.

47 See for example KPMG, Submission 71, p 5.

- It is uncertain as to whether the words 'director' and 'officer' in section 300A have the same meaning as the term ‘executive officer’ in the accounting standard AASB 1034;
- It is uncertain as to whether the disclosure relates to the ‘company’ or the group of companies comprising an economic entity;
- It is unclear as to whether disclosure under the accounting standards is sufficient or whether disclosure has to be duplicated in the directors’ annual report; and
- There is an apparent inconsistency between which officers have to be named under section 300(1)(d) and section 300A(1):

> Subsection 300(1)(d) requires all companies … to disclose details in the director’s report of options granted to any of the “*directors or any of the 5 most highly* ***remunerated*** *officers* as *“part of their* ***remuneration”.*** The differences in the Law in the definition of *“emolument”* versus *“remuneration”* mean that the bases upon which officers are ranked for the purposes of section 300A versus section 300(1)(d) may be different to each other. Therefore, *“the 5 most highly* ***remunerated*** *officers”* under section 300(1)(d) may not be the same people as the *“the 5 named officers of the company receiving the highest* ***emolument****”* under section 300A(1), leading to disclosure of different options details under one section compared to the other.[48]

14.33 The AICD also provided the PJSC with details of apparent inconsistencies between the drafting of section 300A and those in accounting standards AASB 1017 and AASB 1034. In addition, the AICD referred to an inconsistency between section 300A and section 300(l)(d) which requires the disclosure of options granted to directors or to the 5 most highly remunerated officers in the company. According to the AICD these inconsistencies and conflicts could result in totals of emoluments differing between the directors’ report and financial report and the salaries of non-managerial staff being disclosed.[49]

Current arrangements for fixing remuneration and appointing executive officers

14.34 Caltex Australia Ltd pointed out that shareholders are not involved in the appointment and the negotiation of terms and conditions of service of executive officers. The appointment, employment conditions and, if necessary, the removal of executive officers is the responsibility of the board of directors. Caltex Australia Ltd suggested:

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48 Ernst & Young, Submission 31, pp 1-3.

49 Australian Institute of Company Directors, Submission 47, pp 7-8.

> It is presumably intended that by disclosing this information highly paid executives of poorly performing companies would be "shamed" into resigning or reducing their remuneration.
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> They cannot be removed by shareholders, who have no power to do so. Further, the disclosure of remuneration is unlikely to be determinative of the longevity of under-performing executives in any event.[50]

14.35 Mr John Wilkin submitted that shareholders should know or have the means of knowing what a director will receive but not the individual amounts earned by the five highest paid executive officers. The rationale for this is that shareholders vote for and elect directors and each director is severally liable and responsible to the board. The case of executive officers is different, however, because the board is responsible for the remuneration of executive officers.[51]

14.36 It was argued that the question of remuneration is one that is determined by the directors of the company and is, in the final analysis, one of the "day to day" management issues for which the directors are responsible:

> In deciding on the relevant remuneration policy, the directors will need to have regard to the fiduciary obligations that they owe to the company. A discussion of the broad policy of the directors in regard to remuneration may assist shareholders in understanding how the directors have discharged their fiduciary obligations and whether shareholders should continue to entrust the management of the company's affairs in the hands of the incumbent directors.[52]

14.37 GIO Australia Holdings Ltd (GIO) opposed the disclosure of the salaries of executive officers on the basis that executive officers are not appointed by and not accountable to shareholders and that disclosure of salaries in these circumstances is therefore an invasion of privacy.[53]

14.38 Mr JA Sutton told the PJSC that remuneration is a management matter and shareholders should trust the directors to appoint officers who will pursue the objective of maximising the wealth of the company. According to Mr Sutton, any improper conduct can be dealt with at a general meeting and the privacy of individuals should be respected.[54]

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50 Caltex Australia Ltd, Submission 30, p 4.

51 Mr John Wilkin, Submission 21, p 10.

52 Arnold Bloch Leibler, Submission 23, p 11.

53 GIO, Submission 29, p 2.

54 Mr JA Sutton, Submission 57, p 2.

Repeal of section 300A

14.39 Ernst & Young noted that section 300A was included in a late amendment to the Company Law Review Bill. As a result of the drafting of the section the disclosure requirements have lead to inconsistencies in the Law and unintended consequences.[55] It was argued that section 300A should be repealed and replaced by the AASB accounting standard on directors' and executives' remuneration when this will be issued next year. Ernst & Young submitted a survey of listed companies' compliance with section 300A to the PJSC for its consideration.[56] The survey examined the annual reports of listed companies with financial reporting dates in the second half of 1998.

14.40 At the PJSC hearing in Melbourne on 16 June 1999, Mrs Ruth Picker, a Partner at Ernst & Young, summarised the results of the survey and the major areas of concern with the late amendments:

> When we did our survey, what we wanted to do was to find out what was the level of compliance with section 300A amongst our top corporates and how they were interpreting it. We found that there was a lack of consistency, and we expected that, because we felt that 300A was ambiguous. We felt that ASIC practice note in many cases was contestable, because it construed a certain interpretation to come out of section 300A, but the law does not actually prescribe that interpretation. So we felt that, although the practice note had been issued, there was nothing to force companies to comply with that practice note. In fact, they contest it….
>
> The second area that we found concerned the elements of the package to be disclosed. Section 300A just talks about the components or the elements of the remuneration. Companies have interpreted that vastly differently. The breakdown of what is disclosed is different among almost all the companies that we surveyed. ASIC have said, 'These are the components we think you should disclose,' but there is no evidence that companies are following that. The final area-and probably the most controversial one-is whether or not the values of options granted to directors and executives should be included. ASIC have said that they think they should be included. The law is silent on that, and we think there is also a conflict between 300A and 300(1)(d) on options as to whose options need to be disclosed.[57]

55 Ernst & Young, Submission 38a, p 6.

56 Ernst & Young, *Best Practice in the Disclosure of Directors' and Executives' Remuneration*, Corporate Governance Series, April 1999, tabled at the PJSC hearing on 16 June 1999.

57 Mrs Ruth Picker, Committee Hansard, 16 June 1999, p 83-84.

Disclosure of executive officers' remuneration is not in the interests of the company

14.41 GIO argued that disclosure of executive remuneration was not in the commercial interests of the company. The reasons advanced for this argument were as follows:

- The disclosure of salaries will enable other competitive companies to "poach" performing executives; [58]
- The disclosure will lead to the upward pressure on executive packages as lesser paid executives will demand comparability;[59]
- Shareholders have no information against which to benchmark the salary of an executive and to make judgments about the level of salary; and
- Shareholders appoint directors to manage the affairs of the company including the appointment and the remuneration of senior executives. If shareholders are dissatisfied with the management of the company, they are able to change the board.[60]

Previous disclosure regime adequate

14.42 As noted earlier, one of the two principal arguments against the disclosure requirements is that the previous arrangements were adequate. This argument was raised particularly in relation to the requirement that the amount received by directors and executive officers should be disclosed. Caltex Australia Ltd referred to the previous requirement under which companies were required to report the number of officers receiving remuneration in specified "bands":

> This information is more than adequate to enable shareholders to assess whether the directors are generally paying an appropriate level of remuneration to senior officers. In most cases, the managing director will be the highest paid executive and the remuneration of the managing director will therefore be known within a $10,000 range in the event. The previous requirements also gave rise to a lesser potential for disharmony between "envious" employees.[61]

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58 GIO, Submission 29, p 2. See also Freehill Hollingdale and Page, Submission 40, p 5.

59 Australian Institute of Company Directors, Submission 47, p 7; "Overseas experience of this increased disclosure approach, is that there will be a "ratcheting-up" effect; Mr Peter Jooste QC, Submission 48, p 2.

60 GIO, Submission 29, p 2.

61 Caltex Australia Ltd, Submission 30, p 4. See also Permanent Trustee Company Ltd, Submission 46, p 2.

14.43 Similarly, the ALRC suggested that it would be preferable to require the disclosure of all remuneration packages with a value in excess of a particular prescribed amount.[62]

Negative impacts on small listed companies

14.44 The Forest Place Group Ltd opposed the disclosure requirement on the grounds that it would have a negative impact on the working relationships within a small publicly listed company. It advised the PJSC that as a small listed company it did not have a hierarchical structure of senior management. The 5 most highly remunerated executives received a salary in a range of $60,000-$84,000 per annum, including all non-cash benefits, with the 5th ranked executive receiving a salary in accordance with the State Nurses Aged Interim Care Award. The Forest Place Group Ltd submitted that it did not "believe its is the intention of the law to make specific disclosure of such relatively low salary" and recommended that salaries below a benchmarked level, say $150,000, should not be disclosed and disclosure should be as required under AASB 1034.[63]

Conclusions

Accountability and openness

14.45 The overriding principles in respect of directors' and executives' remuneration are those of accountability and openness. The PJSC attaches the highest importance to the full disclosure of directors' and executives' remuneration as a means - to quote from the Greenbury Report – of ensuring accountability to shareholders and public confidence in the capital markets. As witnesses told the PJSC, shareholders are entitled to know the remuneration of directors and executives in all its form and the board's policy in determining directors' remuneration. A number of companies also expressed the view that the disclosure requirements in paragraphs (a) and (b) in section 300A are "inherently reasonable in today's corporate environment" [64] and "either in the interest of shareholders or of more efficient corporate governance." [65]

14.46 The PJSC agrees with the objectives behind paragraphs (a) and (b) of section 300A but as the AICD noted, this requirement might only produce a discussion that states the obvious. The PJSC agrees with the AICD that more meaningful statements will result if boards indicate the manner in which directors' present and future benefits are structured to encourage higher

62 Australian Law Reform Commission, Submission 10, p 6.

63 The Forest Place Group Ltd, Submission 36, pp 1-2.

64 Association of Mining and Exploration Companies Inc, Submission 45, p 4

65 GIO, Submission 29, p 3.

performance. As witnesses told the PJSC, justification for these policies and their relationship to the performance of the company can be at times misleading. For example, a company's share price in a bull market, which may be increasing shareholder value, is not necessarily a true indicator of the performance of directors. A company's performance can also be affected by factors outside the directors' control. On the other hand, a company may be performing well but the board's remuneration policy might be wrong in that the company is not attracting or retaining directors of the quality required, or the board may not be seeking as wide a field of candidates for nomination. The PJSC believes that requirements (a) and (b) may not achieve the objective of informing shareholders that directors' and executives' remuneration realistically reflects the responsibilities and risks of being an effective director or executive.

14.47 In the view of the PJSC the statement of board policy should at a minimum discuss how the remuneration package reflects the responsibilities and risks assumed by the director and the various performance oriented factors linking rewards to corporate and individual performance. It is more relevant for the board's statement to focus on the relationship between the board's remuneration policy and the effectiveness of directors and executives in terms of the risk profile of the company, the board's long term strategic plans and the factors specific to that company.

14.48 The PJSC concludes that section 300A should be amended as follows:

- The word 'broad' should be amended to 'board';
- The words 'senior executive' should be amended to 'executive';
- The reference to 'company' should be retained and that it is intended that this will include executives within an 'economic entity', as referred to in AASB 1034 and in ASIC Practice Note 68, paragraph 55(iv);
- The words 'emolument' and 'emoluments' should be amended to 'remuneration', which has a more general and agreed use than the word emolument and is defined for the purpose the Law intended in Accounting Standards, AASB 1017 and AASB 1034; and
- The words 'details of the nature and amount or each element of the emolument of each director and each of the 5 named officers of the company receiving the highest emolument' should be replaced with 'details of the nature and amount of each element of the remuneration of each director and details of the nature and amount of each element of the remuneration received by the 5 named most highly remunerated executives of the company'.

14.49 The PJSC also concludes that the new accounting standard on directors' and executives' remuneration should require a statement by the board which discusses its remuneration policy and the relationship between that policy and the company's performance and how individual performance is measured, in addition to the responsibilities of directors to encourage higher corporate performance, the risks assumed by the directors and how rewards are related to that policy. The key to encouraging enhanced performance by directors – to quote from the Greenbury Report - lies in remuneration packages that align the interests of directors and shareholders.[66]

14.50 In the view of the PJSC the provisions relating to the disclosure of directors' and executives' remuneration should apply to all listed companies. Companies have a responsibility to shareholders to explain the policy in determining and accounting for directors' and executives' remuneration. If there are areas where full compliance is not practicable, as for example, when executive salaries are based on state industrial awards then relief should be sought from the ASIC, but this should be explained and justified in the annual report.

Unintended consequences

14.51 As witnesses told the PJSC, it is not unusual for companies, particularly small exploration junior companies, to have highly paid staff who are not in positions of management or control of the company or by virtue of the size of the company to have only a handful of employees. Any such disclosure requirement would have an unintended consequence and may result in misleading information being disclosed. The PJSC concludes that a definition of the term 'executive' should be inserted in Section 9 – Dictionary as being 'a person who is involved in the management of the company or entity'. The PJSC believes that this change will provide a basis for uniform remuneration disclosures.

Disclosure and valuation of options

14.52 The PJSC was presented with two surveys of listed companies' compliance with section 300A. In the ASIC survey, non-compliance with the requirement for directors' and officers' emoluments was identified in a small number of annual reports lodged by the 111 companies. While almost all the companies surveyed complied with section 300A, "there were a number of cases where the value of options granted to directors and officers were not included in the emoluments". The Ernst & Young survey indicated a similar disparity in practice between companies. In the view of the PJSC the lack of apparent compliance with section 300A and in particular with the disclosure of

66 Sir Richard Greenbury, *Directors' Renumeration*, Gee Publishing Ltd, London, July 1995, p 11.

a value of options is not due to an unwillingness of companies to comply with the Law but to the fact that the Law is unclear because of the drafting of section 300A. Notwithstanding ASIC policy that an amount should be disclosed for the value of options granted to directors and officers, as the Law currently stands the drafting of section 300A is inconsistent with section 300(1)(d). Section 300(1)(d) does not specify whose options should be disclosed, and section 300A, which requires 'details of the nature and amount of each element of the emolument', does not specify whether or not the details of the emoluments are to aggregated for the purpose of disclosure. Indeed it is questionable whether the Law at present requires the disclosure of a value of options as part of the remuneration package. As the Ernst & Young survey found, the majority of companies issued options to directors and executives in the current financial year and the number of options granted was disclosed. However no value was attributed to the options and it was not clear whether or not the value was included in the remuneration package. As the survey noted, companies returned to the previous practice of attributing no value to options granted. Given the increasingly large amounts involved where options are granted to senior executives, the PJSC believes that the Law should require the disclosure of a value of options in the remuneration package. To resolve an inconsistency in the drafting of section 300A and section 300(1)(d) and the inclusion of a value of options in the remuneration package, the PJSC recommends that:

- Section 300(1)(d)(ii) should be replaced by 'granted to the directors and to the 5 most highly remunerated executives of the company'; and

- Section 300A should include a provision which requires disclosure of the value of options granted, exercised and lapsed unexercised during the year and their aggregation in the total remuneration.

14.53 In Practice Note 68, the ASIC indicated the method of valuation to be used. However, this methodology has been criticised and there is no certainty that this valuation methodology will be used in the future as financial reporting moves towards market value accounting. The PJSC believes that one body should be responsible for developing the method of valuation and that body should be the Australian Accounting Standards Board (AASB). This would be consistent with the AASB's policy to develop a new accounting standard on directors' and executives' remuneration.

Listed Managed Investment Schemes

14.54 The disclosure provisions in section 300A were passed by the Senate with listed companies in mind but the principles of accountability and openness apply equally to listed managed investment schemes. As the PJSC was told, there was no reason for applying the disclosure requirements to listed companies and not to listed schemes which are subject to the same financial reporting requirements. Accordingly, the PJSC concludes that section 300A

should apply to listed managed investment schemes to ensure that the same levels of accountability and transparency apply to these entities.

Recommendation

14.55 The PJSC recommends that sections 300 and 300A of the Corporations Law should be amended as described above.