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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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

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EXPLANATORY MEMORANDUM

(Circulated by the authority of the  
Parliamentary Secretary to the Treasurer, the Hon Bernie Ripoll MP)



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## ***Glossary***

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
CAMAC	Corporations and Markets Advisory Committee
The Bill	<i>Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012</i>
KMP	Key Management Personnel
Corporations Act	<i>Corporations Act 2001</i>
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
FRC	Financial Reporting Council
AUASB	Auditing and Assurance Standards Board
AASB	Australian Accounting Standards Board



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## ***General outline and financial impact***

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### **Outline**

The *Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012* (the Bill) contains measures to enhance the disclosure of executive remuneration in Australia. It implements many of the recommendations made by the Corporations and Markets Advisory Committee (CAMAC) in its 2011 inquiry into executive remuneration in Australia.

The Bill, together with the ‘two-strikes’ reform that was enacted in 2011, strengthens the principle behind Australia’s corporate governance framework that directors are responsible for, and accountable to, shareholders on all aspects of the management of the company, including matters in relation to the remuneration of Key Management Personnel (KMP).

The key executive remuneration measures include:

1. Requiring listed disclosing companies whose financial statements have been materially misstated to either disclose whether any overpaid remuneration to KMP has been ‘clawed-back’, or if no reduction, repayment or alteration of overpaid remuneration has been made, an explanation of why not;
2. Improving disclosure requirements in the remuneration report by:
  - requiring listed disclosing companies to include a general description of their remuneration governance framework;
  - requiring listed disclosing companies to disclose the number of lapsed options and the year which the lapsed options were granted, rather than the value of lapsed options;
  - requiring the disclosure of all payments made to KMP in connection with their retirement from the company; and
  - requiring listed disclosing companies to disclose details of present pay, future pay, and past pay for each KMP.

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

Other measures in this Bill include:

4. Amending the *Corporations Act 2001* (Corporations Act) test for the payment of dividends (the dividends test) to:
  - allow companies to either declare or pay a dividend;
  - link the dividends test to company solvency; and
  - allow non-reporting entities to calculate assets and liabilities with reference to financial records when applying the dividends test.
5. Removing the requirement for some small companies limited by guarantee to appoint auditors if they are not obliged to have their financial reports audited.
6. Amending the *Australian Securities and Investments Commission Act 2001* (ASIC Act) to transfer the remuneration setting responsibility for the offices of the Financial Reporting Council (FRC), Australian Accounting Standards Board (AASB), and the Auditing and Assurance Standards Board (AUASB) to the Remuneration Tribunal.

***Date of effect:***

- Items 1 to 14 of Schedule 1 will commence the day the Act receives Royal Assent.
- Items 1 and 4 to 11 of Schedule 1 will commence the day the Act receives Royal Assent and will apply in relation to directors' reports prepared for financial years starting on or after 1 July 2013.
- Items 1 to 6 of Schedule 2 will commence the day the Act receives Royal Assent.

***Proposal announced:*** The executive remuneration measures were announced by the Government on 21 February 2012.

***Financial impact:*** Nil.

***Human rights implications:*** This Bill does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 5.

*Compliance cost impact:* Nil

## **Summary of regulation impact statement**

### **Regulation impact on business**

*Impact:* As the measures are minor and machinery in nature, a Regulation Impact Statement is not required.



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# **Chapter 1**

## ***Dividends test amendments***

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### **Outline of chapter**

1.1 The Bill amends the Corporations Act for payment of dividends (the dividends test) to:

- allow companies to either declare or pay a dividend;
- link the dividends test to company solvency; and
- allow non-reporting entities to calculate assets and liabilities with reference to financial records when applying the dividends test.

### **Context of amendments**

1.2 The *Corporations Amendment (Corporate Reporting Reform) Act 2010* amended the test for payment of dividends under the Corporations Act to increase the flexibility of companies that seek to make a distribution to shareholders.

1.3 Section 254T of the Corporations Act currently provides that a dividend may only be paid where:

- assets exceed liabilities and the excess is sufficient for the payment of the dividend, immediately before the dividend is declared;
- the payment of the dividend is fair and reasonable to the company's shareholders as a whole; and
- the payment of the dividend does not materially prejudice the company's ability to pay its creditors.

1.4 For the purpose of the dividends test, assets and liabilities are calculated in accordance with accounting standards in force at the time.

1.5 Stakeholders have raised certain concerns about the current dividends test:

- The drafting of the current dividends test creates confusion about when the test should apply. The current drafting of the dividends test may require certain companies to apply the dividends test twice at both the time of declaration and the time of payment.
- The interaction with the Corporations Act capital maintenance provisions (Chapter 2J) remains unclear.
- The requirement for companies to calculate assets and liabilities with reference to accounting standards increases the regulatory burden on non-reporting entities that are not otherwise required to adhere to accounting standards.

1.6 Under the Corporations Act, companies may either declare or determine a dividend. Most companies determine dividends because of the flexibility it provides.

## **Summary of new law**

1.7 The current dividends test will be repealed and replaced with a dividends test that allows companies to:

- either declare or determine a dividend, consistent with Corporations Act dividend provisions and company practice; and
- calculate assets and liabilities based on existing reporting requirements.

1.8 The application of the dividends test will depend upon whether companies elect to declare a dividend or pay a dividend. Where a company declares a dividend, the dividends test will apply immediately before declaration. Where a company determines and later pays a dividend without declaring it first, the dividends test will apply immediately before payment.

1.9 The new dividends test also requires directors to reasonably believe that the company will be solvent, immediately after the dividend is declared or paid.

1.10 The existing duty to prevent insolvent trading under section 588G of the Corporations Act is included as a note to the new dividends test.

### Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>The company's assets exceed its liabilities, and the excess is sufficient for the payment of the dividend.</p> <p>The directors reasonably believe that the company will be solvent immediately after the dividend is declared or paid.</p>	<p>The company's assets exceed its liabilities and the excess is sufficient for the payment of the dividend.</p> <p>The payment of the dividend does not materially prejudice the company's ability to pay its creditors.</p> <p>The payment of the dividend must be fair and reasonable to the company's shareholders as a whole.</p>
<i>Timing</i>	
<p>A company must not declare a dividend unless the dividends test is applied immediately before declaration.</p> <p>Otherwise, a company must not pay a dividend unless the dividends test is applied, immediately before payment.</p>	<p>A company must not pay a dividend unless the dividends test is met immediately before declaration.</p>
<i>Calculation of assets and liabilities</i>	
<p>Assets and liabilities are to be calculated with reference to:</p> <ul style="list-style-type: none"> <li>• accounting standards where a company is required to prepare a financial report;</li> <li>• otherwise, the company's financial records.</li> </ul>	<p>Assets and liabilities are to be calculated in accordance with accounting standards in force at the time.</p>

## **Detailed explanation of new law**

1.11 The first limb of the new dividends test establishes an important safeguard by requiring companies to have sufficient assets in excess of their liabilities in order to pay the dividend.

1.12 The second limb of the new dividends test aligns the dividends test with existing Corporations Act company solvency requirements.

1.13 For the purposes of the dividends test, assets and liabilities are to be calculated:

- with reference to the accounting standards in force at that time, where a company is required to prepare a financial report;
- Otherwise, the most recent financial records of the company.

*[Schedule 1, Part 1- Amendments, item 3]*

1.14 The timing of the new dividends test aligns with Corporations Act provisions on when liabilities are incurred.

- In order to declare a dividend, the dividends test must be met immediately before the dividend is declared; and
- In order to pay a dividend without declaration, the dividends test must be met immediately before the dividend is paid.

1.15 Section 254V of the Corporations Act provides that a debt is incurred at the point where the dividend is declared; otherwise this debt is incurred upon payment of the dividend. The new dividends test will apply immediately before the point at which the company incurs a debt as a result of declaring or paying the dividend.

- The Corporations Act provides for dividends to be declared where the company has a constitution and it provides for the declaration of dividends.
- Stakeholders overwhelmingly supported the amendment of the dividends test to allow companies to satisfy the dividends test regardless of whether they determine or declare a dividend.

1.16 The new dividends test does not displace the existing requirements in relation to conducting share capital reductions and share

buy-backs under Part 2J of the Corporations Act. These provisions will continue to apply under the new dividends test.

1.17 In addition to the requirements outlined above, companies may also be subject to additional regulatory requirements. For example, prudentially regulated entities must comply with regulatory requirements governing the payment of a dividend or reduction in capital. The proposal outlined above will in no way impact upon these more specific requirements, where applicable.

1.18 The dividends test will apply for the purposes of the Corporations Act only. The treatment of dividends under other legislation will continue to apply.

### ***Taxation Issues***

1.19 A central feature of the income tax law is that, to the extent that a company makes a distribution out of profits, that distribution is generally taxed as a dividend and may have franking credits attached to it. Otherwise, it is generally treated as a tax-deferred return of capital, and cannot have franking credits attached to it. A number of integrity provisions in the income tax law reinforce this principle.

1.20 The new dividends test is not designed to change taxation arrangements for dividends.

### ***Companies not required to prepare an audited financial report***

1.21 If a company is not required to prepare a financial report in accordance with accounting standards (for example, because it is a small proprietary company), then the first limb of the test which requires assets to exceed liabilities by the amount of the payment can be satisfied by reference to the financial records that are required to be kept under section 286 of the Corporations Act.

## **Commencement provisions**

1.22 The new law will apply from the day the Act receives the Royal Assent.

1.23 Where a company declares a dividend that has not been paid prior to the commencement of the new law, the current law will continue to apply.

## **Consequential amendments**

1.24 Consequential amendments to other provisions that currently refer to the dividends test are made to Part 1.5 of the Corporations Act.

*[Schedule 1, Part 1- Amendments, item 2]*

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## **Chapter 2**

# ***Improving disclosure requirements in the remuneration report***

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### **Outline of chapter**

2.1 The Bill will amend the Corporations Act to improve disclosure requirements in the remuneration report by:

- requiring listed disclosing companies to include in the remuneration report a general description of their remuneration governance framework;
- removing the requirement to disclose the value of lapsed options, instead requiring companies to disclose the number of lapsed options and the year which the lapsed options were granted;
- requiring the disclosure of details of all payments made to key management personnel (KMP) upon their retirement from the company; and
- requiring listed disclosing companies to disclose for each KMP:
  - (a) the amount that was granted before the financial year and paid to the person during the financial year;
  - (b) the amount that was granted and paid during the financial year; and
  - (c) the amount that was granted but not yet paid during the financial year.

### **Context of amendments**

2.2 Section 300A of the Corporations Act requires the directors' report for the financial year of a listed entity to include a remuneration

report for the KMP to be set out in a separate and clearly identified section.

2.3 The Government asked CAMAC in May 2010 to examine the existing reporting requirements contained in section 300A of the Corporations Act and related regulations and identify areas where the legislation could be revised in order to reduce its complexity and more effectively meet the needs of shareholders and companies.

2.4 The Government also asked CAMAC to make recommendations on how best to revise the legislative architecture behind remuneration reports. This chapter of the Bill implements the recommendations accepted by the Government.

## **Summary of new law**

2.5 The Corporations Act will be amended to require listed disclosing entities to include in the remuneration report a general description of their remuneration governance framework, to the extent that it is otherwise not disclosed elsewhere in the annual report. The remuneration governance framework is a description of the company's process for determining the remuneration of KMP.

*[Schedule 1, Part 1- Amendments, item 4]*

2.6 The requirement to disclose the value of lapsed options and the requirement to disclose the percentage of the value of the KMP's remuneration that consists of options will be removed. Instead, listed disclosing entities will now be required to disclose the number of lapsed options and the year which the lapsed options were granted.

*[Schedule 1, Part 1- Amendments, items 6 & 7]*

2.7 Listed disclosing companies will be required to disclose details of any payments made to all KMP upon their retirement that reflects statutory and other accumulated payments, paid specifically for termination, and a summary of post-severance arrangements.

*[Schedule 1, Part 1- Amendments, item 8]*

2.8 Listed disclosing companies will be required to disclose for each KMP:

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

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

[Schedule 1, Part 1- Amendments, item 5]

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Remuneration governance framework</i>	
Listed disclosing companies will be required to include in the remuneration report a general description of their remuneration governance framework, to the extent that it is not otherwise disclosed in the annual report. The remuneration governance framework is a description of the company's process for determining the remuneration of KMP.	<p>There is no requirement for disclosing entities to provide a description of their remuneration governance framework.</p> <p>However, certain disclosures may already be required, for example, requirements to disclose details relating to remuneration consultants.</p> <p>The ASX Corporate Governance Principles also contains additional disclosures.</p>
<i>Options</i>	
<p>For any options that have lapsed in the current financial year, listed disclosing companies will need to disclose the year in which they were granted. The requirement to disclose the value of the lapsed options will be removed from the Corporations Act.</p> <p>The obligation in section 300A(1)(e)(vi) will be removed given that Item 15 of the Corporations Regulation 2M.3.03 adequately requires disclosure of this information.</p>	<p>Section 300A(1)(e)(iv) provides that disclosing entities must disclose, for each KMP, any options that have lapsed in the current financial year, and the value of the options.</p> <p>Section 300A(1)(e)(vi) requires the disclosure of, for each KMP, the percentage of the value of remuneration that consists of options.</p>

	Item 15 of Corporations Regulation 2M.3.03 requires disclosure of the number and value of any options that have been granted during the reporting period and the number that have vested during that period.
<i>Benefits on termination</i>	
Listed disclosing companies will be required to disclose all payments made to KMP upon their retirement or termination from the company.  In particular, the remuneration report should disclose amounts paid on termination that reflect statutory and other accumulated payments, amounts paid specifically for termination, and a summary of any post-severance arrangements.	Section 300A(1)(e)(vii) requires disclosure of termination benefits provided for under a contract of employment. It does not cover non-contractual payments on termination, and does not cover an arrangement where the departing director and executive provides consultancy services post termination. It does not require distinct elements of the payment to be separately disclosed.
<i>Remuneration outcomes</i>	
Listed disclosing companies will be required to disclose, for each KMP: <ul style="list-style-type: none"> <li>• the amount that was granted before the start of the year and paid during the year;</li> <li>• the amount that was granted and paid during the year; and</li> <li>• the amount granted but not yet paid during the year.</li> </ul>	There is currently no requirement governing how remuneration to KMP should be disclosed.

## Detailed explanation of new law

### *Remuneration governance framework*

2.9 Section 300A of the Corporations Act will be amended to require listed disclosing companies to include in the remuneration report a general description of their remuneration governance framework.

2.10 The remuneration governance framework should include a description of the company's processes for determining remuneration to the KMP.

2.11 If details of the remuneration governance framework are set out elsewhere in the annual report, a cross reference should be provided in the remuneration governance framework section of the remuneration report.

2.12 CAMAC concluded in its report that it is not necessary to legislate specific details that would be required to be disclosed as part of the remuneration governance framework.

2.13 Possible disclosures that could be included in the description of the remuneration governance framework include:

- qualifications and experience of each member of a company's remuneration committee;
- length of time the Chair of the committee has served in that capacity;
- changes in the composition of the committee since the last remuneration report;
- management advice to the committee;
- conflicts of interest that may have arisen and how they were managed; and
- general 'wrap up' information, namely any other information that a shareholder would reasonably require to make an informed assessment of the remuneration governance framework of the company.

### ***Options***

2.14 Section 300A(1)(e)(iv) requires disclosure of the value of options that were held by KMP and lapsed during the reporting year because a condition required for the options to vest was not satisfied.

2.15 Submissions to CAMAC found this disclosure requirement to be of limited use to shareholders.

2.16 Instead of reporting the value of lapsed stock options, listed disclosing companies will now be required to disclose the number of lapsed options and the year in which the lapsed options were granted.

2.17 The requirement to disclose the percentage of the value of remuneration that consists of options will also be removed from the Corporations Act. Item 15 of Corporations Regulations 2M.3.03 already requires disclosure of the number and value of any options that have been granted during the reporting period and the number of options that have vested during that period.

### ***Benefits on termination***

2.18 Subparagraph 300A(1)(e)(vii) provides that, if a member of the KMP is employed by the company under contract, the remuneration report must disclose the duration of the contract, the periods of notice required to terminate the contract, and the termination payments provided for under the contract.

2.19 In addition, *Corporations Regulations 2001 2M.3.03(1) Item 9* requires the disclosure of that person's termination benefits.

2.20 However, questions arise as to the adequacy of the coverage of these disclosure requirements. The legislation currently does not cover non-contractual payments on termination. This may include a discretionary payment, gratuitous bonus or a settlement payment in relation to a dispute over the person's termination. It also does not cover an arrangement where a departing director or executive provides consultancy services post termination.

2.21 Section 300A will now include an additional requirement to disclose details of amounts paid that reflect statutory and other accumulated payments, amounts paid specifically for termination, and a summary of post-severance arrangements, made to all KMP upon their retirement or termination.

2.22 The definition of *benefit* in relation to termination payments is provided in section 200A of the Corporations Act. Details of any benefits that are given in connection with the KMP's termination must be disclosed.

2.23 Section 300A(1)(ea)(i) will apply where failure to provide a benefit to KMP would constitute a contravention of the law (Australian law or elsewhere). This will cover details of any benefits paid that reflect statutory and other accumulated payments (for instance, annual and long service leave and superannuation payments).

2.24 Section 300A(1)(ea)(ii) will cover details of any benefits not covered in Section 300A(1)(ea)(i). This may include:

- payments in settlement of, or in consequence of, potential or actual dispute over dismissal; and/or
- gratuitous and other discretionary payments.

2.25 Section 300A(1)(ea)(iii) requires disclosure of details of any benefits given to, or benefits that will be given to KMP following their retirement from the company. Disclosure will be required where the board enters into arrangements with a departing KMP to provide consultancy or other services to the company in the future.

### ***Remuneration outcomes***

2.26 Listed disclosing companies will now be required to disclose remuneration for each KMP in three separate categories.

2.27 Listed disclosing companies will be required to disclose the amount of remuneration that was granted before the financial year and paid during the financial year. This will be required regardless of whether the performance period is longer than a year.

2.28 The **amount** that is disclosed will be the amount that is paid to KMP.

*[Schedule 1, Part 1, Section 300A(1)(ca)(i)]*

2.29 Listed disclosing companies will be required to disclose the amount that was granted and paid during the financial year.

*[Schedule 1, Part 1, Section 300A(1)(ca)(ii)]*

2.30 Listed disclosing companies will be required to disclose the amount that was granted but not yet paid during the financial year.

*[Schedule 1, Part 1, Section 300A(1)(ca)(iii)]*

2.31 Presenting information in this way will assist shareholders to distinguish clearly between present pay, future pay, and pay that has been received due to past pay being crystallised.

2.32 This will mean listed disclosing companies will now report what is realised pay for KMP.

## **Application and transitional provisions**

2.33 The new law will apply to directors' reports for a financial year beginning on or after 1 July 2013.

2.34 This legislation applies to listed disclosing companies that are required to produce a remuneration report.

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## **Chapter 3**

# **Clawback of remuneration**

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### **Outline of chapter**

3.1 The Bill amends the Corporations Act by requiring listed disclosing companies whose financial statements have been materially misstated to disclose whether any overpaid remuneration to KMP has been ‘clawed-back’, and if not, to provide an explanation.

### **Context of amendments**

3.2 In order to align shareholder and managerial interests, many companies have performance-based remuneration for their KMP that generally consists of both fixed pay and variable pay. This remuneration structure is dependent on both financial and non-financial performance indicators.

3.3 Therefore, amounts paid to KMP are often directly linked to figures contained within the financial statements.

3.4 When a financial statement is subsequently found to be materially misstated or have a material omission, there is a possibility that KMP have been overpaid.

3.5 Material misstatements or omissions in the financial statements can occur either through deliberate misconduct or unintentional error, and may be large enough to influence the decision making of investors and other stakeholders. For example, the company’s share price may be artificially inflated due to the misstated financial information, resulting in larger bonuses for the directors or executives.

3.6 Currently, there is no legislative requirement for a company to disclose whether they have clawed-back remuneration in situations where material misstatements or omissions have led to KMP being overpaid.

3.7 The current framework lacks transparency as shareholders have limited means to express their views or take action without adequate disclosures regarding a company’s clawback policy.

3.8 This legislation introduces a disclosure requirement for a company's clawback policy. However, the choice to clawback remuneration remains with the board.

3.9 Should shareholders remain unsatisfied by a company's clawback policy, they have the ability to hold the board accountable through the 'two-strikes' test. The 'two-strikes' test provides a mechanism for shareholders to 'spill' the board of directors, if a company does not adequately respond to shareholders' concerns on remuneration over two consecutive years.

3.10 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.

3.11 As disclosure is conditional on the occurrence of material misstatements, administrative costs associated with additional disclosures would be minimised.

3.12 The discussion paper *'The clawback of executive remuneration where financial statements are materially misstated'* was released by the Government in December 2010 seeking public comments on how clawback can be implemented. The consultation closed on 30 March 2011.

3.13 The majority of submissions were opposed to adopting a prescriptive approach in relation to clawing-back remuneration, and indicated a preference for a principles-based approach.

## **Summary of new law**

3.14 The new rules apply to listed disclosing companies who become aware, during the financial year, of material misstatements in any of their three previous financial statements.

3.15 These companies must disclose in their current year remuneration report whether any overpayment to KMP as a result of the misstatement has been or will be clawed-back.

3.16 If no remuneration has been clawed-back, an explanation must be provided.

**Example 1.1**

Marcus is paid \$1,500,000 in 2012 as the Chief Executive Officer at McKillop Ltd. His payment included a \$500,000 fixed income component and a \$1,000,000 variable component based on the financial performance of McKillop Ltd. Marcus’s variable income component includes 10% of any reported profit made by McKillop Ltd in 2012. The \$10,000,000 profit made by McKillop Ltd in 2012, entitled Marcus to a \$1,000,000 bonus in 2012.

In 2013, McKillop Ltd becomes aware of material misstatement in the financial statements of 2012, reducing their reported profit down to \$0 in 2012. McKillop Ltd will be required to disclose whether any of the excess \$1,000,000 paid to Marcus in 2012 has been, or will be clawed-back, in the 2013 Remuneration report. If the excess will not be clawed-back, an explanation must be provided in the remuneration report.

**Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
Listed disclosing companies who become aware during the financial year of material misstatements in any of their three previous financial statements must disclose in the remuneration report whether any overpaid remuneration paid to KMP as a result of the misstatement has been or will be clawed-back. If no remuneration has been clawed-back, an explanation must be provided.	There is no provision for disclosing entities to disclose their clawback policy in the event of material misstatements in financial reports.

**Detailed explanation of new law**

3.17 Under the new law, if a company:

- becomes aware during the current financial year of any material misstatements or omissions in any of their previous three financial statements; and

- that misstatement or omission leads to a KMP being overpaid; then
- that company must disclose whether the overpayment to KMP has been, or will be, clawed-back; or if the overpayment has not been, and will not be, clawed-back, an explanation must be provided in the remuneration report.

*[Schedule 1, Part 1- Amendments, item 9]*

3.18 This requirement will only be triggered if the company becomes aware of a material misstatement or omission in the financial statements of the entity in any of the previous three financial years.

3.19 If no material misstatement or omission is made, the company will not be required to disclose their clawback policy.

3.20 The company will only be required to disclose the clawback of remuneration in the financial year they become aware of the material misstatement or omission. Beyond this year, future clawback disclosures for the same material misstatement will not be required, regardless of whether that material misstatement is still within the previous three financial statements.

3.21 Further clawback disclosures will only be triggered by other material misstatements or omissions.

3.22 The materiality of misstatement or omission refers to the concept of materiality in the accounting standards.

- *Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor*

*[Schedule 1, Part 1- Amendments, item 1]*

*[AASB 1031 – Materiality]*

3.23 If overpaid remuneration has been, or will be, clawed-back, details must be provided in the remuneration report. The method of clawback is up to individual companies to decide. However, the clawback of remuneration would ordinarily include:

- a reduction in future pay for KMP;

- a repayment of previous overpaid remuneration that was paid to KMP; or
- another form of alteration of a KMP's remuneration.

### **Application and transitional provisions**

3.24 The new law will apply to directors' reports for a financial year beginning on or after 1 July 2013.

3.25 This legislation applies to listed disclosing companies that are required to produce a remuneration report.



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## **Chapter 4**

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

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### **Outline of chapter**

4.1 Currently both listed and unlisted disclosing entities that are companies need to prepare a remuneration report. The Bill will require only listed disclosing companies to prepare remuneration reports.

### **Context of amendments**

4.2 Section 300A of the Corporations Act currently requires all disclosing entities that are companies to prepare a remuneration report — this includes listed and unlisted companies.

4.3 As unlisted disclosing companies are not subject to the ‘two-strikes’ test, the preparation of a remuneration report is less relevant.

4.4 Unlisted disclosing companies therefore will be relieved from the obligation to prepare remuneration reports.

### **Summary of new law**

4.5 Only listed disclosing companies will be required to prepare remuneration reports under section 300A.

### **Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
Unlisted disclosing companies will be relieved from the obligation to prepare a remuneration report.	Both listed and unlisted disclosing entities that are companies need to prepare a remuneration report.

## **Detailed explanation of new law**

4.6 Section 300A(2) will be narrowed to impose the requirements to prepare remuneration reports only on listed disclosing companies rather than any disclosing entity that is a entity.

*[Schedule 1, Part 1- Amendments, item 10]*

## **Application and transitional provisions**

4.7 The new law will apply to annual reports produced on or after 1 July 2013.

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## **Chapter 5**

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

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### **Outline of chapter**

5.1 Some public companies, such as certain companies limited by guarantee, will be relieved from the obligation to appoint auditors, as they are no longer required to have financial reports audited following the introduction of the *Corporations Amendment (Corporate Reporting Reform) Act 2010*.

### **Context of amendments**

5.2 In 2010, a three-tiered differential reporting framework was introduced under the *Corporations Amendment (Corporate Reporting Reform) Act 2010*. This Act exempted small companies limited by guarantee from the requirement to produce audited financial reports.

5.3 The first tier comprises companies limited by guarantee with annual revenue less than \$250,000 that do not have deductible gift recipient status.

5.4 Companies in the first tier were exempt from preparing the financial report and the directors' report. They were also exempt from having the annual report audited.

5.5 The second tier companies comprise companies limited by guarantee with annual revenue of less than \$250,000 that are deductible gift recipients and companies limited by guarantee with annual revenue of \$250,000 or more but less than \$1 million.

5.6 Companies in the second tier could elect to have financial reports reviewed rather than audited.

5.7 However, currently all public companies, including companies limited by guarantee, must appoint auditors.

## Summary of new law

5.8 Companies limited by guarantee under first and second tiers will be exempted from appointing auditors, as they are not required to have financial reports audited.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Companies limited by guarantee with annual revenue less than \$1 million will not have to appoint auditors.	All public companies, including all companies limited by guarantee, must appoint auditors.

## Detailed explanation of new law

5.9 Companies limited by guarantee with annual revenue of less than \$1 million will be exempted from appointing auditors, as they are not required to have financial reports audited.

### *Exception for Commonwealth companies or subsidiaries of Commonwealth companies and Commonwealth authorities*

5.10 The following entities are excluded from the proposed reforms applying to companies limited by guarantee:

- a Commonwealth company;
- a subsidiary of a Commonwealth company; or
- a subsidiary of a Commonwealth authority.

*[s301(3)(a)(i, ii, iii) of the Corporations Act 2001]*

5.11 The directors of a Commonwealth company (a company subject to the Corporations Act that the Commonwealth controls, whether they are companies limited by shares or companies limited by guarantee) are required to comply with the annual reporting requirements in the *Commonwealth Authorities and Companies Act 1997* (CAC Act).

5.12 The annual reporting requirements in the CAC Act currently require the directors of a Commonwealth company to provide to their responsible Minister the company's financial report, directors' report and auditor's report required by the Corporations Act for a financial year, as if the company were a public company under the Corporations Act. As Commonwealth companies and subsidiaries of Commonwealth companies and Commonwealth authorities still require audited financial reports, such entities will require the appointment of an auditor.

5.13 This exclusion ensures such entities, who still require continue to maintain the higher level of reporting that is appropriate given that the entity is controlled by the Commonwealth.

## **Application and transitional provisions**

5.14 The new law will commence on the day after this Act receives the Royal Assent.



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## **Chapter 6**

# **Remuneration setting for certain statutory office holders**

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### **Outline of chapter**

6.1 Section 2 to the Bill amends the *Australian Securities and Investments Commission Act 2001* (ASIC Act) to transfer the remuneration setting responsibility for the offices of the Financial Reporting Council (FRC), Australian Accounting Standards Board (AASB), and the Auditing and Assurance Standards Board (AUASB) to the Remuneration Tribunal.

### **Context of amendments**

6.2 Currently, the ASIC Act provides that the terms and conditions (including remuneration and any recreation leave entitlements) of the Chairs of the three bodies and the members of the FRC, are determined by the Minister. The terms and conditions of the members of the AASB and the AUASB are determined by the FRC.

Current provisions – ASIC Act	FRC	AASB	AUASB
Chair	235A(2) (Minister)	236B(6) (Minister)	236F(8) (Minister)
Members	235A(2) (Minister)	236B(6) (FRC)	236F(9) (FRC)

6.3 The new arrangements, which bring the remuneration and any full-time member recreation leave entitlements of the Chairs and members of the three bodies within the determinative jurisdiction of the Remuneration Tribunal, will provide for consistency in the remuneration setting arrangements between the three bodies, as well as with similar bodies under the ASIC Act, for example the Takeovers Panel.

6.4 There will be overall efficiency gains as the Remuneration Tribunal has specialist skills in reviewing and determining remuneration, and is therefore better placed to determine the remuneration of these offices.

## Summary of new law

6.5 The new law will amend existing arrangements and provide for the Remuneration Tribunal to determine the remuneration and any full-time member recreation leave entitlements of the Chair and members of the FRC, AASB, and the AUASB, rather than the Minister or the FRC.

6.6 Other terms and conditions not determined by the Remuneration Tribunal will continue to be determined by the Minister, or the FRC where relevant.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The remuneration and recreation leave entitlements (in the case of a full-time office) of the Chair and members of the FRC, AASB and AUASB will be determined by the Remuneration Tribunal.	The remuneration and recreation leave entitlements (in the case of a full-time office) of the Chair and members of the FRC, AASB and AUASB are determined by the Minister, or the FRC where relevant.
Other terms and conditions, including allowances and recreation leave entitlements for part-time members, will continue to be determined by the Minister, or the FRC where relevant.	Other terms and conditions, including allowances and recreation leave entitlements for part-time members, are determined by the Minister, or the FRC where relevant.

## Detailed explanation of new law

6.7 Under the current provisions, the terms and conditions of the Chairs of the three bodies and the members of the FRC are determined by the Minister. The terms and conditions of the members of the AASB and the AUASB are determined by the FRC.

6.8 The new law transfers the responsibility for the determination of remuneration and recreation leave entitlements (for full-time offices) to the Remuneration Tribunal, consistent with other bodies under the ASIC

Act, such as the Takeovers Panel. This also provides for consistency in the remuneration setting arrangements between the three bodies.

6.9 The Minister, or the FRC in the case of AASB and AUASB members, will continue to determine other terms and conditions not covered by the determination issued by the Remuneration Tribunal. This includes allowances, and recreation leave for part-time offices. The Minister may also grant leave of absence for full-time offices, and determine the associated terms and conditions.

6.10 The Bill repeals the existing subsection 235A(2) and replaces the provision with arrangements which provide for the remuneration of FRC members, including the Chair, to be determined by the Remuneration Tribunal. The Remuneration Tribunal will also determine the recreation leave entitlements for any full-time members. Where there is no determination issued by the Remuneration Tribunal in operation, the Minister is to determine the remuneration and the recreation leave for full-time members in writing. Other terms and conditions not determined by the Remuneration Tribunal, including allowances and recreation leave for part-time members, will continue to be determined by the Minister in writing. The Minister may also grant leave of absence to full-time offices, and determine the associated terms and conditions.

*[Schedule 2, Part 1, items 1 to 2, subsection 235AA]*

6.11 The Bill repeals the existing subsection 236B(6) and replaces the provision with arrangements which provide for the remuneration of the AASB Chair and members to be determined by the Remuneration Tribunal. The Remuneration Tribunal will also determine the recreation leave entitlements for any full-time members. Where there is no determination issued by the Remuneration Tribunal in operation, the Minister is to determine the remuneration and the recreation leave for full-time members in writing. Other terms and conditions not determined by the Remuneration Tribunal, including allowances and recreation leave for part-time members, will continue to be determined by the Minister in writing. The Minister may also grant leave of absence to full-time offices, on terms and conditions determined by the Minister.

*[Schedule 2, Part 1, items 3 and 4, subsections 236BA and 236BB]*

6.12 The Bill repeals the existing subsections 236F(8) and 236F(9) and replaces the provisions with arrangements which provide for the remuneration of the AUASB Chair and members to be determined by the Remuneration Tribunal. The Remuneration Tribunal will also determine the recreation leave entitlements for any full-time members. Where there is no determination issued by the Remuneration Tribunal in operation, the Minister is to determine the remuneration and the recreation leave for

full-time members in writing. Other terms and conditions not determined by the Remuneration Tribunal, including allowances and recreation leave for part-time members, will continue to be determined by the Minister in writing. The Minister may also grant leave of absence to a full-time Chair or full-time members, on terms and conditions determined by the Minister.

*[Schedule 2, Part 1, items 5 and 6, subsections 236FA and 236FB]*

## **Application and transitional provisions**

6.13 The new law will commence on the day after this Act receives the Royal Assent.

6.14 If the new law has commenced and there is no determination issued by the Remuneration Tribunal in operation, Chairs and members who are receiving remuneration and other terms and conditions according to what the Minister determines in writing will continue to receive these amounts.

6.15 If the new law has commenced and there is no determination issued by the Remuneration Tribunal in operation, Chairs and members appointed after the commencement of the new law will receive remuneration and other terms and conditions according to what the Minister determines in writing.

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## **Chapter 7**

# **Statement of Compatibility with Human Rights**

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**Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

***Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012***

7.1 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

### **Overview**

7.2 The Bill contains measures to enhance the disclosure of executive remuneration in Australia. It implements many of the recommendations made by the Corporations and Markets Advisory Committee (CAMAC) in its 2011 inquiry into executive remuneration in Australia.

7.3 The Bill, together with the ‘two-strikes’ reform that was enacted in 2011, strengthens the principle behind Australia’s corporate governance framework that directors are responsible for, and accountable to, shareholders on all aspects of the management of the company, including matters in relation to the remuneration of Key Management Personnel (KMP).

7.4 The Bill also includes a number of other measures that:

- Increases the flexibility for companies to pay dividends;
- Removes inconsistencies in auditor appointment.
- Improves consistency of remuneration setting for multiple accounting boards.

### **Human rights implications**

7.5 This Legislative Instrument engages Article 17 of the International Covenant on Civil and Political Rights (ICCPR).

7.6 Article 17 protects the right to privacy and reputation. This Legislative Instrument infringes on Article 17, as it:

- Expands the disclosure provided to the public regarding executive remuneration and remuneration of members on the FRC, AUASB and the AASB.

7.7 The Legislative Instrument's limitation on the right to privacy is considered reasonable, necessary and proportionate to achieve the objectives of the Legislative Instrument. Further, the benefits to public order resulting from improving disclosures regarding remuneration are considered to outweigh the limitation on the right to privacy.

### **Conclusion**

7.8 This Legislative Instrument is compatible with human rights. While this Legislative Instrument infringes on the right to privacy under Article 17 of the ICCPR, it does so to protect the public order. The benefits resulting from this Legislative Instrument are considered to outweigh the limitation it places on Article 17.

**The Hon Bernie Ripoll MP, Parliamentary Secretary to the Treasurer**