CHARTERED SECRETARIES
AUSTRALIA

*Leaders in governance*

16 November 2005

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Chair
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The BRAG Secretariat
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Dear Ms Walter

## Business Regulation in Australia

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on specific issues that we believe should be examined and resolved in the short term, in the context of Australian corporate regulation. In Australia, CSA has over 8,500 members and affiliates representing the majority of public companies listed on the Australian Stock Exchange (ASX), many proprietary companies across the country and organisations in the public and not-for-profit sectors.

Part of good governance is ensuring that there is a balance between the achievement of the community's social, environmental and economic objectives through regulation and the imposition of costs via regulation on businesses that impede economic growth.

While it is not feasible within the short timeframe allocated by the Business Regulatory Advisory Group to comment on all areas of corporate regulation, CSA is able to comment on two recent examples of duplication of regulation, where streamlining or rationalising the operational impact and harmonising corporate regulation would improve business efficiency.

CSA notes that the first example could be resolved in the short term by amendments to the *Corporations Act* (see CSA's proposed solution below).

In the second example, CSA notes that further examination of the issues would assist in ensuring that duplication of regulation is not solidified.

### *Example 1: proposal to remove AASB 1046 and add information to Standard 124*

Currently corporations need to report against two parallel, but differing standards on director and executive remuneration. These standards sit in section 300A of the *Corporations Act* and in Australian Accounting Standard Board (AASB) 1046. The AASB is proposing to remove AASB 1046 and add information to Standard 124 on this issue.

CSA notes that the AASB, in proposing to remove AASB 1046 on *Director and Executive Disclosures by Disclosing Entities* and add information on this area to Standard 124 on *Related Party Disclosures*, is seeking to align the two governing standards. CSA welcomes the attempt to rectify the duplication of effort and reporting, as well as the confusion engendered by differing definitions in two separate standards.

However, CSA strongly believes that the proposal to remove AASB 1046 on *Director and Executive Disclosures by Disclosing Entities* and add information on this area to Standard 124 on *Related Party Disclosures* will not solve the problem. In proposing to remove the definitions of specified director, executive and specified executive (including the requirement to specify at least five executives with the highest authority) and rely solely on the definition of 'key management personnel' (KMP) already existing in AASB 124, the AASB is compounding the problem by moving from one set of differing definitions to another.

***The problem with the proposal***

The major problem is that the KMP definition potentially covers a larger category of executives. KMP refers to 'those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity'.

The Exposure Draft notes that the AASB expects the KMP to include all executives required by section 300A of the *Corporations Act*, which specifies five named company executives and five named group executives with the highest remuneration. CSA notes that this is a hopeful expectation, and one that cannot guarantee alignment.

Companies are just coming to grips with the remuneration report requirements in their current form, with the attendant difficulties of differing definitions. Changing definitions again, as proposed in the Exposure Draft, will add further to the confusion, not ameliorate it.

Furthermore, CSA notes that Standard 124 uses the word 'compensation', rather than remuneration. Thus another definitional difference will be introduced.

***Practical difficulties encountered in implementing two different standards in 2005***

In 2005, corporations had to devote both additional time to trying to report against two parallel, but differing standards, and also additional expense as they had to bring in external legal advisers to ensure that they were meeting the two differing standards.

Under Standard 1046, problems were also experienced by the audit profession in interpretation, with some auditors insisting that the audit and audit report were to be only of the financial accounts and not the directors' report. This interpretation required a duplication of information at considerable additional cost. The adoption of Standard 124 does not seem to overcome this difficulty.

It is difficult for all corporations to interpret the current regulatory requirements, especially where a group of corporations may be involved, for example, where a holding company may have very few employees. The introduction of the definition of KMP to a listed holding company may, in some instances, apply to only one or two executives.

Many CSA members have complained of duplication and confusion between AASB Standard 1046 and section 300A of the *Corporations Act*. As stated earlier, Standard 124 does nothing to address this and in fact introduces a further confusing term – KMP

***CSA's proposed solution***
CSA recognise that not all bodies regulated by the accounting standards fall under the *Corporations Act*. CSA is aware that the AASB needs to ensure that all bodies it regulates report on remuneration.

CSA strongly recommends that, as the accounting standards are part of the corporations law, all bodies that fall under the *Corporations Act* should report against its standard on remuneration reporting (section 300A and regulations, expanded as necessary to deal with the material currently in the accounting standards). The AASB can issue a standard that adopts the *Corporations Act* requirements by reference, with necessary adaptation for the other groups it regulates that are not covered by the Act.

If this recommendation is implemented, those charged with governance reporting, as well as their directors, will only have to report to one standard.

*Example 2: APRA draft prudential governance standards*

Earlier in 2005, the Australian Prudential Regulatory Authority (APRA) released draft prudential governance standards that would apply to the major authorised deposit-taking institutions (ADIs), as well as general insurers, life insurers and authorised non-operating holding companies (NOHCs), superannuation trustees and fund managers.

CSA lodged a submission with APRA on its areas of concern, that largely had to do with the duplication of governance standards. We were concerned that listed companies were already required to report against the ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendat*ions, and that a considerable compliance burden would be imposed on companies by having to report also against a further set of parallel, but differing, governance standards.

CSA would like to note that we believe from discussions with APRA that it has taken heed of many of the submissions it has received on this issue, and is looking at revising its standards to ensure that some areas of duplication are removed. However, there will still be duplication on the issue of board composition requirements, including composition requirements for subsidiaries. This is of particular concern in relation to the potential confusion for a director of a wholly-owned subsidiary as to what authority they should follow, that is, the APRA governance standards, the constitution of the entity or the *Corporations Act*, to ensure they are acting in the best interests of the holding company or in the best interests of the subsidiary itself.

***APRA-regulated subsidiaries in a corporate group where the parent company is also APRA-regulated***

CSA notes that the ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* already deal with board composition requirements and that APRA's proposals differ from them.

CSA supports the appointment of a majority of non-executive directors. However, it notes that, while board members and senior managers of the parent company are eligible to act as non-executive directors, finding a suitable pool of individuals to serve as independent directors may prove difficult when teamed with APRA's requirement to have an independent chairman and, in particular, to have an independent financial expert on these regulated subsidiary boards.

While APRA has suggested that independent directors from the parent company board may serve as independent directors on these subsidiary boards, the issue of whether they will have sufficient time to properly carry out that role will inevitably arise, given that any independent director serving on those boards will almost undoubtedly also need to serve on that company's

audit committee. Introducing a requirement for an individual financial expert to serve on the boards of these subsidiaries will only further narrow the pool of suitable candidates.

CSA also considers that it would be onerous to require a company of up to seven directors to appoint what are, in effect, three independent directors (including the independent chairman). Four independent directors are required on boards with more than seven directors. This over-emphasis on independence may dilute the quality of specific industry expertise on boards. Rather than the current proposed approach, CSA would suggest that the majority of directors on the board of an APRA-regulated subsidiary should be non-executive, with only one independent member plus the chairman required to sit on the board. The chairman and financial expert could then be selected from both the non-executive and independent elements of the board.

CSA notes that the draft standards comment on an APRA-regulated holding company, or indeed any APRA-regulated and non-APRA-regulated entities within a group, making decisions that are not in the best interests of other APRA-regulated entities within a group. CSA believes it is important to clarify that, in practice, the activities of many subsidiaries exist to benefit their holding company. The current drafting of the standards raise questions as to what a subsidiary can do when it is seeking to assist the holding company to its own detriment, which is amplified when the holding company is overseas. For example, can a holding company withdraw cash from a subsidiary if APRA believes it is to the detriment of the subsidiary? Capital adequacy ratios could be affected and CSA believes APRA needs to provide guidance on what constitutes 'detriment'. In addition, given that in most cases a majority of independent directors will be required on the subsidiary board and APRA's requirement that their duty to the company overrides any section in the constitution that permits them to act in the interests of the parent or the group, conflicts could regularly arise if the independent directors of the parent company are the ones on the board of the regulated subsidiary, leaving the board without a quorum to act.

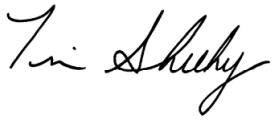
CSA is also concerned that the APRA governance standards specify that an APRA-regulated entity will not be able to engage in the activities stated above even if an entity's constitution expressly authorises the board or individual directors to act in the interests of another group member. This may lead to confusion for a director of a wholly-owned subsidiary as to what authority they should follow, that is, the APRA governance standards, the constitution or the *Corporations Act*, to ensure they are acting in the best interests of the holding company or in the best interests of the subsidiary itself.

Notwithstanding this, until the revised standards are made public, it is difficult to ascertain the degree of duplication between the APRA governance standards and the ASX Corporate Governance Council's guidelines.

### *Conclusion*

In preparing this submission, CSA has drawn on the expertise of the members of its two internal national policy committees. We would welcome the opportunity to meet with you to discuss any of our views in greater detail. Please call me if you would like to set up a meeting. I can also arrange a meeting with our members.

Yours faithfully



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