

Remuneration Report Audit Alert

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INTRODUCTION

Section 308(3C) of the Corporations Act requires the auditor's report on the Company's financial report to include a report on whether the Remuneration Report complies with section 300A of the Corporations Act (s300A). The Remuneration Report is, of course, the main annual document through which boards of ASX listed companies communicate to shareholders the company's policies and practices in relation to remuneration of key management personnel (KMP). The Remuneration Report and the notice of meeting for the annual general meeting (AGM) are the documents that are perused by proxy advisors, funds managers, superannuation funds and other stakeholders to form views on voting on resolutions concerning KMP remuneration. Thus, the Remuneration Report is a critical document for various stakeholders who need to be confident of its accuracy. This confidence is increased through the Remuneration Report being audited. However, it appears that auditors have been experiencing difficulties in forming views on s300A compliance due to a lack of documentation evidencing the policies being represented in Remuneration Reports. This lack of policy documentation has also made the work of Remuneration Committees unnecessarily complex.

JUST EVIDENCE NEEDED FOR THE AUDITOR, OR POWERFUL TOOLS?

In order to form an opinion that a Remuneration Report complies with s300A the auditor would need to see evidence to support the policies and practices disclosed in the Remuneration Report. Such policies and practices need to be consistent unless variations are explained. This is where a significant proportion of ASX listed companies are running into problems; often their remuneration policy only exists to the extent it is summarised in the Remuneration Report. Auditors correctly recognise the importance of ensuring there is a suite of well documented policies to cover remuneration governance. However by the time the auditor raises this it is often too late to start developing and implementing the necessary policies before the Annual Report goes to print. They are then caught in a difficult position of having to form a view on s300A compliance without a complete document trail, which is not ideal.

However, the significance of developing policy documents is not to pass audit. Rather policy documents have the power to streamline the work of the board, improve decision making, guide good governance and ensure remuneration practices are optimised. This is the reason such policies are required in the first place.

Remuneration Policy Documentation

The first requirement of s300A is a "discussion of broad policy for determiningthe nature and amount of remuneration for key management personnel". Basic evidence of a policy is formal written documentation. In relation to KMP remuneration such documentation would include:

- A. For non-executive directors (NEDs):
 - a. A NEDs remuneration policy and procedure,
 - b. A NED securities policy governing the provision of securities as part of NED remuneration, if applicable,
 - c. NED shareholding policy, if applicable,
- B. For executives:
 - a. Executive remuneration policy and procedure,
 - b. Executive short term incentive (STI) policy and procedure,
 - c. STI plan rules,
 - d. STI invitations for participants,

- e. STI Explanatory booklet,
 - f. Executive long term incentive (LTI) policy and procedure,
 - g. LTI plan rules,
 - h. LTI invitations for participants,
 - i. LTI Explanatory booklet,
 - j. Executive shareholding policy, if applicable, and
- C. A general share trading policy that applies to KMP and all employees.

In GRG's experience it is usual for LTI plan rules, invitations, explanatory booklets etc. to be well documented but for virtually all other elements of KMP remuneration to be inadequately documented, if documented at all. GRG has found that the process of drafting and reviewing policies and procedures can be very useful for boards in confirming that current approaches are appropriate or identifying aspects where different approaches are more appropriate to a company's circumstances.

Validation That Stated Policies Are Being Applied

Given that s300A requires detailed information on the remuneration of each KMP to be disclosed it is important for the auditor to confirm that the remuneration practices are consistent with the stated policies or differences are explained. This may occur for example when a company adopts a new remuneration policy and current remuneration practices need to be migrated over time to be consistent with the new remuneration policy.

Relevant market practice information will be needed for this purpose and the board should have obtained such information when reviewing KMP remuneration. Such information is generally obtained from the board's external remuneration consultant (ERC) who also provides recommendations on KMP remuneration. The ERC's report can represent good evidence that the stated remuneration policies are being applied by the board. Of course, if there is a material difference between the stated policy and remuneration practices and such difference are not adequately explained then the accuracy of the stated policies comes into question. This may preclude the auditor from forming an opinion that the Remuneration Report complies with this aspect of s300A.

ERC Remuneration Recommendations Free From Undue Influence

Under s300A(1)(h)(vi) the Remuneration Report needs to include "*information about the arrangements the company made to ensure that the making of the remuneration recommendation would be free from undue influence by ... key management personnel ... to whom the recommendation relates*". Evidence of such arrangements should take the form of a policy regarding the engagement of, work undertaken by and recommendations provided by ERCs. In the absence of such a policy it may be difficult for auditors to form an opinion that the Remuneration Report complies with this aspect of s300A.

ENSURE EVIDENCE IS PREPARED BEFORE REMUNERATION REPORT AUDIT STARTS

Once the Remuneration Report is drafted it is too late to start drafting remuneration policies. Relevant documentation should be drafted and adopted by the board well before drafting of the Remuneration Report commences.

Once drafted, a remuneration policy should be viable for some years unless the company's circumstances change. The main reason for drafting remuneration policies is not to have them available for auditors, although this is a good reason to have them prepared well in advance (a process which may take some months). The process of drafting remuneration policies forces boards to consider in detail the various elements of each policy. Such consideration is best undertaken without time pressure or influenced by specific circumstances that need to be addressed in a given Remuneration Report.

Once established the remuneration policies can provide a reference sources and guidance when addressing specific remuneration issues. It avoids having to "reinvent the wheel" as tends to occur when the matters needing to be resolved have not been considered at a policy level. Thus, the time invested in developing and documenting policies will be recouped many times over when the policies are being applied to specific circumstances as they arise from time to time.

Having sound KMP remuneration policies combined with a transparent comprehensive Remuneration Report will also minimise the possibility of a "strike" being received when the Remuneration Report resolution is voted on at the AGM.

GRG has considerable experience in assisting Remuneration Committees to develop and document the policies and associated, procedures etc. needed to appropriately govern KMP remuneration at the board level.