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The Chairman
Australian Accounting Standards Board
PO Box 204
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Dear Chairman

ED 143 "Director and Executive Disclosures by Disclosing Entities: Removal of AASB 1046 and Addition to AASB 124"

We are pleased to submit our comments in relation to Exposure Draft ED 143 "Director and Executive Disclosures by Disclosing Entities: Removal of AASB 1046 and Addition to AASB 124".

Overall, we do not support the Australian Accounting Standard Board's (AASB) proposal to amalgamate AASB 1046 with AASB 124 as we believe that the quality and quantity of disclosing entity disclosures will be affected, as will the relief currently provided to listed companies under the *Corporations Regulation Amendment No.4 (July 2005)*. AASB 1046 was issued to provide a consistent and coherent regime of improved corporate governance disclosure for disclosing entities that would bring Australia closer to overseas requirements. AASB 1046 is a domestic standard and should be retained as a separate standard together with its detailed guidance, consistent with the Board's retention of other domestic standards. It would also enable the Standard to be amended for changes to the Australian environment and would not be affected by changes made to International Financial Reporting Standards (IFRS) by the International Accounting Standards Board (IASB). Instead we recommend that the Board consider amending AASB 1046 and AASB 124 to ensure they are consistent with IAS 24 and provide additional guidance for the Australian environment.

Our comments on the specific proposals outlined in the Exposure Draft and other issues which we would like to bring to your attention are addressed below.

A. SPECIFIC MATTERS FOR COMMENT

1. Proposal to remove parent relief from AASB 124

(a) Proposal to remove parent relief from AASB 124

We support the removal of parent entity relief from AASB 124 for the following reasons:

- Currently, an entity that complies with AASB 124 will be in compliance with the requirements of IAS 24 but only in relation to the consolidated financial statements. The parent entity

financial statements would not be in compliance with IAS 24, where no additional disclosures are provided under AASB 124 in relation to the Key Management Personnel (KMP) of the parent as required under IAS 24. The proposal will ensure the Australian Standard is consistent with IAS 24 and therefore any entity complying with AASB 124 will also be in compliance with IFRS.

- For listed entities, it will ensure consistency with the Remuneration Report requirements under s300A of the Corporations Act which require remuneration disclosures for the executives of the parent as well as the executives of the group.

(b) Proposal to rely on the definition of KMP

We support the proposal to rely on the term of "Key Management Personnel" (KMP) but do not support the removal of the terms "specified directors", "executive" and "specified executives".

The IFRS definition of "KMP" is vague and has been interpreted very widely and differently by preparers of financial statements who have applied IAS to date. It is therefore our opinion that including Australian paragraphs which specifically require the KMP of the entity to include the specified directors and specified executives of the entity will not result in a Standard which is not IFRS compliant but will rather assist in clarifying its application in the Australian environment.

The Board has stated in the Preface that it considers the term KMP to capture the relevant people responsible for an entity's governance. We do not agree with this statement. While the definition of KMP specifically includes a reference to the directors of the entity, there is no reference to the inclusion of executives either in the definition of KMP or in any commentary to the proposed Standard. When issuing AASB 1046, the Board stated that the concept of "executive" is consistent with the definition of KMP used in IAS 24. Similarly, the Board has stated in the Preface to ED 143 that due to the similarity in definitions between executive in s300A of the Corporations Act and KMP in AASB 124, the Board expects the KMP group for a listed company will generally include all executives identified by s300A. However, there is no clear reference to "executive" in the proposed Standard. In the absence of any specific requirement to include such persons, it is likely that entities may consider only their directors as KMP. It is therefore very important for the Board to continue to include Australian specific paragraphs which require entities to include in their KMP group, specified executives as is currently required by AASB 1046 and AASB 124 (June 2004 version).

While we support the retention of the term KMP, we believe that the definition of the term KMP is ambiguous and guidance must be provided by the Board as to the intended meaning of this term in order to avoid inconsistencies in its interpretation. The non-provision of guidance will make it difficult for preparers of financial statements to interpret the requirements of the standard in a consistent manner, thereby reducing the relevance, reliability and comparability of the information disclosed to users of the financial statements. Some of the interpretative issues with the definition of KMP include:

- The definition of KMP includes any individual who has the "authority and responsibility for planning, directing and controlling the activities of the entity, including any director of the entity". It is unclear whether the individual concerned must be responsible for all of the activities of the entity and not just one or some of the activities, or whether is it the Standard's intention that it relates to a major activity of the entity. It could be argued that only the

directors of the parent would have power over all the activities of the entity, such that no other employees, including those in an executive capacity, would be caught as KMP.

- The point in time at which the individual must meet the definition of KMP in order to be selected is unclear. It could be implied from a strict interpretation of the definition that only those persons who are a KMP at the end of the reporting period would be caught. Therefore, any person who was a KMP during the year but who retires, resigns or is terminated prior to year end would not be disclosed. On the other hand, the definition of "specified executive" and "specified director" specifically included any person who held that position during the reporting period.

- The definition of KMP includes "any director of the entity". Where consolidated financial statements are prepared, the KMP of the consolidated group will include the directors of all other entities in the consolidated group, e.g. directors of subsidiaries. Under AASB 1046 and s300A, only the directors of the parent are caught by the disclosures. This means that under the proposals in ED 143, directors of all controlled entities may be caught, resulting in a significant amount of additional disclosures, especially for larger groups. We believe the Board should include guidance which limits the term KMP to the directors of the parent only.

2. Scope of AASB 124

AASB 124 (July 2004) already applies to non-corporate for-profit entities. We therefore assume that the proposal is that AASB 124 be required to be applied by both for-profit and not-for-profit non-corporate entities (and not AAS 22), other than public sector entities.

If this is the case, then we support this proposal as it is consistent with the Board's approach to issuing sector neutral standards. However it should be noted that while the current version of AASB 124 exempts non-corporate entities which apply AASB 124 from complying with AAS 22, this exemption is not proposed in ED 143. We therefore believe that this exemption should be included in ED 143.

ED 143 exempts public sector entities from complying with paras 1-22 but there is no exclusion for the rest of the Standard. While such paragraphs are only applicable to disclosing entities, to avoid confusion, it would be best to exempt the entire standard from applying to public sector entities.

The term "public sector entity" is also not defined in the Accounting Standards. The Board should consider providing such a definition to enable entities to determine whether they fall within this category. For example, it is generally understood that this term includes all entities controlled by Government. If this is the case, then this would include Telstra Corporation and the Reserve Bank of Australia which means that they would not be required to apply paras 1-22 of ED 143, however, as Telstra is a disclosing entity it would be required to apply the paragraphs relating to disclosing entities.

3. Amalgamation of AASB 1046 with AASB 124

We do not support the amalgamation of AASB 1046 with AASB 124, as we believe that the quality and quantity of disclosing entity disclosures will be affected. Our reasons for not supporting amalgamation are as follows:

- AASB 1046 is a domestic standard and should be retained as a separate standard without the need for it to be amalgamated into AASB 124. Its retention as a separate standard would be consistent with the Board's retention of other domestic standards. It would also mean that the Standard could be amended for changes to the Australian environment and would not be affected by changes made to the IFRS by the IASB.

- A major factor influencing the issue of AASB 1046 was the need for improved governance disclosures for disclosing entities and the need to provide a consistent and coherent regime of disclosure that will bring Australia closer to overseas requirements. The development of the Standard was a result of benchmarking Australian requirements with the requirements in the USA and the UK. As such, retention of AASB 1046 would be considered important in ensuring Australian requirements are in line with those of overseas jurisdictions.

- Retention of a separate standard will be easier for disclosing entities to identify the requirements which specifically apply to them rather than including them within a standard which applies to all other entities preparing general purpose financial reports.

- Amalgamation of AASB 1046 into AASB 124 would mean that the requirements of ED 143 would be subject to the requirements of other AIFRS Standards. For example, ED 143 would be subject to the application of AASB 1 "First-time Adoption of Australian Equivalents to International Financial Reporting Standards" requiring the revised AASB 124 to be applied retrospectively. As noted in question 12 below, this would cause difficulties as it may require disclosing entities to provide comparative disclosures for persons who were KMP but not specified directors or specified executives in the comparative period under AASB 1046. In addition, while AASB 1046 currently provides an exemption from providing comparatives for individuals for certain disclosures, all the disclosures under ED 143 would be subject to the generic comparative requirements of AASB 101 "Presentation of Financial Statements". The effect of this does not appear to be contemplated nor correctly reflected in ED 143. For example, Appendices 3 and 4 continue to reflect the comparative exemptions provided under AASB 1046.

- The removal of the detailed guidance and appendices to the existing AASB 1046 will make it difficult for users to interpret and apply its requirements. As discussed in question 1 above, ED 143 includes the term "KMP" however provides very little guidance as to its interpretation and application.

- For listed companies, withdrawal of AASB 1046 will invalidate the Corporations Regulation Amendment No.4 (July 2005) which provides relief to such entities from duplication of the remuneration disclosures for their directors and executives. The Government will be required to issue a new regulation for such relief to continue to be available. However, it is uncertain at

this stage whether such relief will be available for December 2005 year end entities given the limited time frame for it to be issued by Parliament and perhaps even June 2006 year ends. These implications are further discussed in detail in Section B1 below.

We recommend that the Board consider retaining AASB 1046 as a separate Australian standard. If the Board decides to do so, then AASB 1046 will need to be amended to ensure it is consistent with AASB 124, e.g. consistent terminology with respect to KMP and compensation. In addition, AASB 124 should also be also amended to ensure that an entity which complies with AASB 124 is also in compliance with IAS 24 and to provide additional guidance for the Australian environment especially in relation to the application of the terms KMP and compensation.

4. Specified director, executive and specified executive

We support the proposal to rely on the term "Key Management Personnel" (KMP) but do not support the removal of the terms "specified directors", "executive" and "specified executives". The IFRS definition of "KMP" is vague and has been interpreted very widely and differently by preparers of financial statements who have applied IAS in the past. It is therefore our opinion that including Australian paragraphs which specifically require the KMP of the entity to include the specified directors and specified executives of the entity will not result in a Standard which is not IFRS compliant.
We also believe that guidance must be provided in relation to the term "KMP" in order to avoid inconsistencies in its interpretation. Refer to our detailed comments at (1)(b) above.

5. Subtotals for compensation and loans for directors and non-director KMP

We do not agree with the proposal to delete the requirement to disclose subtotals for loans and compensation for directors and non-director KMP (i.e. requiring only one KMP total).

Requiring only one KMP total is consistent with the fact that the proposed Standard does not differentiate between director and non-director KMP and is also consistent with s300A which does not require separate totals for directors and executives.

However, we have found in practice that most listed companies do present in their Remuneration Report under s300A, director and non-director remuneration in separate tables with separate totals, as this more clearly reflects the differences in remuneration structures for such groups of persons. The ASX Corporate Governance Principles also clearly distinguish between the structure of non-executive director and executive remuneration. Requiring sub-totals enables investors and analysts to distinguish between the remuneration of the two types of KMP.

We therefore believe that separate totals for compensation should be maintained. While the cost of providing such sub-totals would be minimal, it would impose a burden on investors and analysts of having to identify director and non-director KMP and calculate subtotals to assist them in comparing remuneration across entities.

6. Former KMP.

We do not agree with the proposal to remove the existing para Aus 18.1.

As the definition of "related party" in para 9 of the AASB 124 does not include former KMP, there is a risk that this category of persons would not be considered a related party by entities when complying with AASB 124, if para Aus 18.1 is removed. It should be noted that the ED has also removed para Aus 9.3. There is a risk that significant related party transactions may not be subject to disclosure. For example, assume director A is a KMP for the 2005 financial year and is terminated and receives a significant payout in the 2006 financial year. As he is not a KMP for the 2006 financial year, the entity would avoid disclosure of the payout, if there was no requirement to disclose transactions with former KMP. It would be possible for entities to manipulate the timing of the termination to avoid disclosure of huge lump-sum payouts as remuneration.

It is recommended that if the Board decides to remove Aus 18.1, it should include in the definition of related party in para 9, former key management personnel.

7. Prescribed benefits

We support the proposal to delete the AASB 1046 requirement for separate disclosure of prescribed benefits in each component of the five categories of compensation. Prescribed benefits (whether post-employment or otherwise) are required to be approved by members in any case – as such their separate disclosure does not provide members with any additional information.

8. Entities that have to disclose details of KMP

We support the proposal that all entities covered by AASB 124, not only disclosing entities, be required to disclose certain minimum descriptive information in respect of each key management person (refer to paragraph Aus16.1) and information on changes that occur in the period after the reporting date and prior to the date when the financial report is authorised for issue (refer to paragraph Aus16.2). This will ensure consistency and comparability of disclosures by reporting entities. Post balance sheet date changes in KMP are as relevant for other reporting entities as they are for disclosing entities. These disclosures should not represent a significant cost to provide.

9. Incorporation of section 300A(1)(ba) into AASB 124 paragraph Aus25.3

We do not support the Board's proposal to incorporate section 300A(1)(ba) of the Corporations Act into AASB 124.

The main reasons for not supporting the proposal are as follows:

- The additional disclosures will be required to be provided by all disclosing entities as opposed to s300A which only applies to listed companies. This will result in a significant amount of additional disclosures for disclosing entities which are not listed companies.

- For listed companies, we cannot see the benefit of including the s300A disclosures in the financial report where such disclosures are already provided in the Directors' Report. Where the exemption for transfer under the regulations is not adopted by listed companies, this will result in further duplication of information in the directors' report and financial report. The intention of Corporations Regulation 2005(No.4) was to remove duplication. This will only add to this problem by causing further duplication of these disclosures.

- Currently, the disclosures required by s300A(1)(ba),(d) and (e) are not subject to audit. Incorporation of these disclosures into AASB 124 mean that they will be subject to audit, however this will be difficult as most of these disclosures are subjective.

- The proposal will have significant implications for disclosing entities which are not listed companies such as Managed Investment Schemes.
  1. As noted above, the requirements of s300A(1) apply only to listed companies and no other disclosing entities. On the other hand, the proposals in ED 143 will apply to all disclosing entities. In the Government's Response to the Report of the Parliamentary Joint Committee on Corporations and Securities – Matters Arising from the Company Law Review Act 1998, it stated that the Government did not support the application of s300A to directors and senior executives of responsible entitles of investment schemes (whether listed or unlisted) on the basis that unit holders in a MIS do not have any ownership interest in the responsible entity that manages the scheme's assets. We believe that the Government's reason for not requiring application to MIS is significant and should be taken into consideration by the Board.

  2. As discussed below at proposal 13, we do not support that any of the disclosing entity disclosures should be applicable to MIS. Significant difficulties have been encountered by MIS in practice in determining who their specified executives are under the current AASB 1046, and we expect that such difficulties will also be encountered in determining their KMP under ED 143. There will also be difficulties in obtaining remuneration information for such persons, in particular, the detailed information of performance plans/conditions for individual KMP of the MIS, as required by the proposed Aus 25.3(c), where those persons are not employed by the scheme or responsible entity. We believe that the additional costs of obtaining this information would significantly outweigh any benefits (if any at all) to be gained from providing such information to the unit holders of the MIS.

Other issues to note

While the proposal states that the AASB is proposing to incorporate section 300A(1)(ba) of the Corporations Act into AASB 124, in fact it is also proposing to incorporate sections 300A(1) (d), (e)(i) and (e)(vii). These are not reflected in the Preface or the Proposals section of the exposure draft.

In addition, while it is proposed to incorporate sub-sections (i) and (vii) of 300A(1)(e)– subsections (ii)-(vi) – have not been incorporated. The Board has provided no commentary as to the reason it is proposing to include some and not other subsections of 300A(1).

10. Do you agree that the "other transaction" disclosures in paragraphs Aus25.5.3 to Aus25.7 should be by individual director when the disclosures in paragraph 18 are disaggregated into "key management personnel of the entity or its parent" and "other related parties"?

We are of the opinion that the "other transaction" disclosures in paragraphs Aus25.5.3 to Aus25.7 should be by individual KMP when the disclosures in paragraph 18 are disaggregated into "key management personnel of the entity or its parent" and "other related parties". These disclosures are consistent with the current AASB 1046 disclosures.

It should be noted however that in the proposal above, the Board is only referring to disaggregating other transaction disclosures by director – does this mean that it does not contemplate there would be any KMP other than directors?

11. No Appendices to final revised AASB 124

We do not agree with the Board's proposal to delete all the Appendices to this ED when issuing the final revised AASB 124. In our opinion, the guidance and illustrations contained in the Appendices are relevant to an understanding of the requirements of the proposed Standard and provide useful examples of the disclosures and presentations required by the Standard. In fact, it is our view that not only should the current Appendices be retained, but additional appendices should be included to provide guidance in relation to the terms "KMP" and "compensation" consistent with the detailed guidance provided in AASB 1046. Retention of the appendices is consistent with the Board's approach to including Australian guidance in other AIFRS standards.

We also do not support the removal of the Appendix to AASB 1046 which reiterated UIG 14 as this appendix was very useful to preparers of financial statements as well as advisors in interpreting the elements to be included in remuneration as well the classification of the elements to the various components. We recommend that the Board reinstate this Appendix as part of the revised AASB 124, amending it as appropriate to reflect the components in AASB 124/119.

We note that paragraph A3 of Appendix 1 is inconsistent with the AASB's previously stated position (AASB Media Release dated 21 June 2004) regarding the inclusion of remuneration disclosures where it is not practicable to make a reasonable or meaningful allocation of remuneration to individuals.

12. Transitional provisions

Where the Board removes AASB 1046 and incorporates its requirements into AASB 124, then we believe that the Board should include transitional relief on first time adoption of the revised AASB 124 to exempt disclosing entities from providing comparatives for persons who were KMP but not specified directors or specified executives in the comparative period under AASB 1046.

Due to the lateness of this exposure draft and the fact that it has not been exposed early enough to enable disclosing entities to consider its requirements, such information would not have been collected, especially the detailed components of remuneration, making it difficult for a disclosing entity to provide such comparative information in its first AIFRS financial report.

Costs to collect and retrieve relevant data and to generate the required disclosures would significantly outweigh the benefits from providing such comparative disclosure.

13. Application to managed schemes (including MIS)

(a) We do not agree with the proposal that when a managed scheme (including a MIS) pays a management fee to its responsible entity, the managed scheme indirectly provides the compensation of the KMP for managing the MIS for the purposes of paragraph 16 for the following reasons:

i) employees of a responsible entity are not KMP of a scheme

In our view, the officers and employees of a responsible entity (or similar) are not the KMP of a managed scheme, trust, or superannuation fund. Rather, the relationship of a responsible entity is that of service provider to the scheme. This is notwithstanding ASIC's guidance contained in Practice Note 68 "New financial reporting and procedural requirements" which clarifies that, for the purpose of sub-section 285(3) of the Corporations Act, the directors of a responsible entity are considered to be the directors of the scheme. This guidance was necessary to confirm the ability of the directors of the responsible entity to perform those acts necessary for the preparation and signing of the scheme's financial statements under Chapter 2M of the Act.

However, ASIC Practice Note 68.140-.141 states, 'Concerns have been expressed by some that the application of s 285(3)(b) would necessitate disclosure [under s300A] in registered scheme financial statements of any amounts paid to the directors and executive officers of a responsible entity which are supported by the fees paid by a registered scheme to the responsible entity. Section 285(3)(b) does not apply in this manner.' This view is consistent with the Government's Response to the Report of the Parliamentary Joint Committee on Corporations and Securities – Matters Arising from the Company Law Review Act 1998, discussed at question 13(b), below.

We concur with the guidance currently provided in paragraph 5.1.2 of AASB 1046 which states:

"The phrase "directly or indirectly", as used in this Standard with reference to remuneration, has the effect of including all amounts paid, payable, provided or otherwise made available to specified individuals in connection with the management of the entity and its *subsidiaries*, whether directly to them or indirectly through an intermediary or through their *personally-related entities* (including *relatives*). In some cases it may be difficult to determine whether an amount concerned is remuneration or an "other transaction" required to be disclosed by Section 10 of this Standard. For example, a *specified director* may be a partner in a partnership that receives fees from the *disclosing entity*. The partnership is a *personally-related entity*. Whether payments by the *disclosing entity* to such a partnership form part of remuneration or are "other transactions" of the *specified director* will be a matter of fact, determined by reference to the meaning of remuneration. If, for example, the fees were solely for professional services rendered by the partnership, then they would be disclosed as part of "other transactions" of the *specified director*. However, if the fees were paid in respect of services rendered by the

specified director in managing the entity, then the amount would be included in the remuneration of the *specified director*."

In our view, the above commentary is equally valid and relevant in interpreting the requirements contained in AASB 124. Management fees paid by a scheme or trust to its responsible entity are in return for services rendered by that entity. They may include such services as office rent, custodial fees, audit, accounting and tax services, and other administrative costs as well as management services. Consequently, we believe disclosure of the management fees should be made in accordance with paragraph 12 rather than paragraph 16 of AASB 124.

ii) inability to identify KMP of an MIS employed by a service provider

It is often the case that neither the MIS nor its responsible entity has any employees. For some MIS, personnel employed by an unrelated third party management company providing management services to the MIS may meet the definition of KMP of the MIS. While it is possible to determine KMP employed by a scheme, it is impractical to expect that the responsible entity can require or direct the external service provider to provide details of their personnel and their remuneration for the purpose of complying with the requirements of paragraphs 16 and Aus 25.2 of AASB 124, especially in cases where that service provider is not a disclosing entity and is not required to prepare information in accordance with Aus25.1 – Aus 27.7.3.

Where the responsible entity is unable to obtain that information from the unrelated management company, which may include commercial-in-confidence considerations, the Board considers this to be a breach of AASB 124 by the MIS, potentially causing non-compliance with Accounting Standards.

Consequently, we recommend that the Board provide Australian application guidance confirming that the KMP of the MIS is limited to those persons employed by the MIS and its controlled entities.

iii) remuneration to KMP of a service provider does not represent cost of governance of the scheme

We accept that it is relevant for the members of a scheme to understand and identify the cost of governance of that scheme. However, we believe that the management fee paid or payable to the responsible entity or other entities involved in the management of the scheme represents that cost of governance of the scheme.

Such management fee generally represents the cost of providing a range of goods and services to the scheme (including a trading margin for the other party) but does not directly correlate to any individual cost that may be incurred by that party in the provision of those services to the scheme. The adoption of the proposals in the Exposure Draft results in disclosures that are arbitrary and potentially does not provide meaningful and relevant information to users of the financial report.

KMP compensation is an economic question for the responsible entity and is unrelated to the management fees received from the managed schemes, which are driven by market factors. An example that demonstrates that there is not an indirect link between management fees paid and KMP compensation is as follows:

Management could choose to structure a responsible entity to undertake the investment management and custody arrangements for a scheme, employing personnel and directly providing services to that scheme ('Structure A'). An alternative arrangement would be for the responsible entity to outsource all investment management and custody services to third parties and not to employ any staff ('Structure B'). Both structures can be observed in industry.

The management fees paid by the schemes under the two structures would be the same (assuming comparable investment mandates etc.). However, under Structure A, in accordance with the requirements of ED 143, there is potentially a number of KMP that could be identified with the associated disclosures in the scheme's financial statements. Under Structure B, it would be possible only to identify the directors of the responsible entity as KMP. In Structure B, most of the management fees received by the responsible entity would be paid to the unrelated investment manager and custodian. Since the employees of the investment manager and custodian are not employees of the responsible entity or the scheme, it is not possible to obtain details of their compensation.

The cost of governance for both schemes remains the same but, by assuming a link between management fees received by the responsible entities and the KMP compensation, the disclosures and implications for both schemes are vastly different. In reality, the choice of outsourcing or compensating KMP is an economic decision by the responsible entity based on their internal cost structures. The management fees paid by the scheme are based on market forces and, as can be seen in this example, do not directly or indirectly link to KMP compensation. Furthermore, they are unlikely to influence decisions of investors regarding the allocation of resources as both schemes would have similar cost structures, investment yields and distribution rates.

In our opinion, the cost of governance of the schemes is the management fees paid by the scheme and that fee should require disclosure by the scheme.

iv) management fees paid by a scheme does not meet the definition of compensation in AASB 124 and IAS 24

Notwithstanding the above, in our opinion the management fee paid by a scheme does not meet the definition of compensation in AASB 124 and IAS 24.

Compensation is defined as 'all employee benefits (as defined in AASB 119: Employee Benefits) including employee benefits to which AASB 2: Share-based Payment applies. Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity.'

Management fees paid by the scheme rarely bear any relationship to compensation that the management personnel of the responsible entity or other entity may receive. In our opinion, when no consideration is paid by the scheme to those persons either directly, or indirectly by another party on the instruction of the scheme, or where those costs will be reimbursed by the scheme, those fees do not meet the definition of compensation and the MIS, therefore, makes no compensation payments to the KMP of the responsible entity.

(b) We do not agree that the KMP of managed schemes that are disclosing entities (including MIS) should be subject to the same disclosure regime as all other disclosing entities in paragraphs Aus25.1 to Aus25.7.3.

In our opinion, the nature and structure of managed schemes are substantially different to corporate entities. We agree that it is relevant for corporate disclosing entities to disclose the remuneration of their KMP because that information is relevant in understanding the cost of governance of the entity and the relationship between the remuneration of KMP and the entity's performance. However, for the reasons set out above, those relationships do not exist in the majority of managed schemes. Consequently, we do not agree that managed schemes that are disclosing entities (including MIS) should be subject to the same disclosure regime as all other disclosing entities in paragraphs Aus25.1 to Aus25.7.3 unless that scheme directly remunerates KMP employed by the scheme or any controlled entity.

We note that the application of section 300A(1) of the Corporations Act is restricted to listed companies rather than all listed entities. The Government's Response to the Report of the Parliamentary Joint Committee on Corporations and Securities – Matters Arising from the Company Law Review Act 1998, stated that it did not support the extension of section 300A to directors and senior executives of responsible entities of investment schemes (whether listed or unlisted) for the following reasons:

'Section 300A requires listed companies to disclose the remuneration of directors and senior executives to shareholders who, as the owners of the company, have an equitable interest in the affairs of the company, including payments received by company officers and management.

The position of unit holders (or members) in a managed investment scheme is fundamentally different from that of shareholders in a company. Members of a managed investment scheme do not, as members, have any ownership interest in the responsible entity that manages the scheme's assets. As a consequence, it is not appropriate for managed investment schemes to provide members with information about the remuneration of the directors and other company officers of the scheme's responsible entity.

Members do, however, receive information about fees and charges imposed by the responsible entity through the Corporations Law prospectus requirements. This provides unit holders with sufficient information to make decisions on the relative merits and costs of the different schemes in which they could invest.'

In our opinion, the disclosure of the management fees paid by schemes to its responsible entity provides more relevant and useful information to the users of the financial statements than the

disclosures proposed by the Exposure Draft, which bear no relationship to the cost of governance of the entity.

(c) We do not agree that the KMP of a managed scheme are among the individuals paid by the responsible entity (or by another entity that provides services to the responsible entity).

Except where the MIS or its controlled entities directly employ personnel who would meet the definition of KMP of the scheme, we do not agree to extend that requirement to the KMP paid by another entity that 'provides services' to the responsible entity. We are concerned that the extension of the identification of KMP of a managed scheme to those individuals paid 'by another entity that provides services to the responsible entity' will be impractical for the responsible entity to identify and obtain that information.

Refer also to our comments at questions 13(a) and (b), above.

(d) International Practice

We have had discussions with our overseas counterparts to determine whether inclusion of indirect remuneration of director's/KMP of investment funds would be consistent with overseas practice. From what we can gather, in both the US & UK, regulated investment funds generally have their own independent board of directors. Consistent with Australia, they often have a fund manager/advisory firm that receives a fee based on NAV or performance based criteria. The fund manager will appoint one or more directors to the board of the fund, these directors may be on the boards of a number of other funds. If they are remunerated by the fund, their remuneration would be disclosed, however if the remuneration is paid by the fund manager (i.e., indirectly, out of the management/advisory fee) it would not be disclosed.

In some cases (in the US at least) the company (separate to the fund manager/advisor) that carries out tasks such as book keeping and administrative activities will also appoint directors to the fund. Again, if these directors are remunerated indirectly through the administration fee, there is no disclosure required.

Our colleagues in both countries were somewhat surprised at the situation that we described re MIS in Australia. The idea of disclosing the indirect remuneration in addition to administration fee/management fee paid to the directors' employer was surprising to them. They struggled to see how it was relevant or how a meaningful allocation could be made.

14. Are there any other disclosure requirements you believe should be: (a) added; or (b) deleted?

In our opinion, there are no other disclosure requirements which should be added or deleted.

15. Are the proposals in the best interest of the Australian economy?

We do not believe that the proposals to amalgamate AASB 1046 into AASB 124 are in the best interests of the Australian economy for the reasons set out in the questions above.

We also do not believe that the proposals improve, clarify or enhance the usefulness of the information contained in the financial reports of managed investment schemes and trusts, superannuation funds and similar entities now brought within the scope of the proposed standard and, for the reasons set out in questions 11 to 13 above, are not, therefore, in the best interests of those sectors of the Australian economy.

B. OTHER COMMENTS

1. Interaction of Accounting Standards with the Corporations Act

*Listed companies **adopting** Corporations Regulation 2M.6.04*

"Corporations Regulation 2M.6.04 – Annual Financial Reports - Listed Companies" exempts listed companies from providing remuneration disclosures required in their annual financial reports by AASB 1046 on the condition that those disclosures are included in the annual Directors' Report under the heading of "Remuneration Report" and are audited.

The withdrawal of AASB 1046 will make Regulation 2M.6.04 invalid. Treasury will therefore be required to amend this regulation for December year end listed companies to be able to avail themselves of this exemption. This amendment will need to occur within a very short time frame after 31 December 2005 in order to be effective. There is uncertainty at this stage whether such relief will be available for December 2005 year end entities and perhaps even June 2006 year ends.

*Listed companies **not adopting** Corporations Regulation 2M.6.04*

Where the exemption to transfer the remuneration disclosures into the Remuneration Report is not adopted, a listed entity must continue to comply with Reg.2M.3.03 which requires remuneration disclosures for prescribed persons in accordance with AASB 1046.

Discussion with Treasury has indicated that there is currently no intention to amend this regulation, as it refers to the version of AASB 1046 in force at the time it was legislated and therefore will not be affected by the issue of the revised AASB 124. As such, any listed companies which do not adopt the exemption and continue to comply with Reg. 2M.3.03 will be required to provide remuneration disclosures for their prescribed persons in accordance with AASB 1046 in the Remuneration Report, which means compliance with a standard that is no longer applicable. On the other hand, the remuneration disclosures relating to their KMP in the notes to the financial statements will need to be compliant with the revised AASB 124.

As discussed above, the use of the term KMP may result in a different group of people disclosed in the financial report to the prescribed persons included in the Remuneration Report under s300A. While the definition of KMP specifically includes a reference to the directors of the entity, there is no reference to the inclusion of executives either in the definition of KMP or in any commentary to the proposed Standard. The Board has stated in the Preface to ED 143 that due to the similarity in definitions between executive in s300A of the Corporations Act and KMP in AASB 124, the Board expects the KMP group for a listed company will generally include all executives identified by s300A. However, there is no clear reference to "executive" in the proposed Standard. In the absence of any specific requirement to include such persons, it is likely that entities may consider only their directors

as KMP. As such, it is quite likely that a different group of persons may be disclosed in the remuneration report compared to the financial report.

In addition, the components required to be disclosed under the revised AASB 124 will be different to the components to be disclosed under AASB 1046 in the directors' report. The main changes include the proposal to replace the "primary benefits" component with the "short-term benefits" component, include a new component of "long term benefits", relocate the "other benefits" component to "short term benefits" and change the "equity compensation" component to "share based payment compensation". This will have the following implications:

- Currently, any bonuses which are long term incentives are included in primary benefits. Under the proposed revised AASB 124, these will not be included in short term benefits, but will be shown separately as a long term benefit component.
- Any accrual for long service leave previously included as part of "primary benefits" will also be reclassified to the "long-term benefit" component.
- In addition, the relocation of the 'all other' component to the category of "short-term employee benefits" will means that any lump sum sign-on payments and insurance premiums paid to indemnify directors or executives which were previously included in the "other benefit" component will now be included as part of the short term benefits.
- Currently, any cash-settled share based payments are included as part of primary benefits. Share-based based payments which are equity-settled are included in a separate component. ED 143 is proposing to change the equity compensation component to share based payment compensation. This will therefore include all share-based payments, whether equity or cash settled.

It is quite likely that amounts disclosed under the components for AASB 124 for the same individual would be different to the amounts disclosed under the components for AASB 1046. Where a listed entity has not adopted the exemption to transfer the remuneration disclosures into the Remuneration Report, these differences will result in inconsistencies between the components disclosed in the financial report under the revised AASB 124 and the components disclosed in the Remuneration report under AASB 1046 for the same individual, thereby causing confusing to users of the annual report.

Assuming that Parliament makes the Regulation mandatory for June years ends (as is the current intention) we expect that this issue will only be a problem for December year end listed companies which do not adopt the exemption to transfer under Regulation 2M.6.04. In the mean time, we believe that Board should discuss this issue with Treasury with a view to Treasury reconsidering the reference in Reg. 2M.3.03 to a Standard which is no longer applicable, if the Board decides to remove AASB 1046.

2. Guidance to be provided on what constitutes "compensation"

The Board is proposing to change the term 'remuneration' as used in AASB 1046 to 'compensation' as used in IAS 24. We support this proposal as it will ensure that the terminology and requirements under AASB 124 are IFRS compliant. However, the Board should provide additional guidance in relation to the term "compensation". Appendix 5 is currently very light on guidance (one paragraph only) considering the interpretation issues which would be expected to arise in this area, and

compared to the amount of guidance on "remuneration" provided in AASB 1046. In contrast, ED 143 provides two and a half pages of guidance on equity holdings. The non-provision of guidance will make it difficult for preparers of financial statements to interpret the requirements of the standard in a consistent manner, thereby reducing the relevance, reliability and comparability of the information disclosed to users of the financial statements.

"Compensation" is defined to include all employee benefits (as defined in AASB 119 *Employee Benefits*) including employee benefits to which AASB 2 *Share-based Payment* applies. Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity.

Although the disclosure requirement sounds straight-forward, it is unclear from the Standard the basis on which the amount for each of the categories is to be determined so that a meaningful total is disclosed. For example, is it the amount paid or the amount payable by the entity (or on its behalf); is it those amounts paid/payable during the period; or the amount paid/payable for services during the period; or is it the expense recognized for the period under the relevant Standard?

In addition, the term "remuneration" was previously restricted to payments made in connection with provision of management services to entity and its subsidiaries. "Compensation" relates to all services provided, however no guidance is provided as to what "all services" means. For example, assume a director is also a partner in legal firm and provides legal services to company. The company pays the legal firm for these services. Previously such payments would by excluded from remuneration because the services do not relate to management of company. It is unclear whether such amounts would be included as compensation under ED 143. European experience with the term "all services" is that it is vague. As such it is very important for guidance to be provided to ensure consistent interpretation in the Australian environment.

In the Basis for Conclusion accompanying IAS 24, the IASB noted that the guidance on compensation in IAS 19 is sufficient to enable entities to disclose the relevant information, which might suggest that the amount to be disclosed as compensation is the amount recognized as an expense under IAS 19. However, this comment has not been revised following the issue of IFRS 2.

Some issues relating to the employee benefits determined under AASB 119 and AASB 2 are as follows:

- In relation to short-term employee benefits, ED 143 requires the amount of "paid" annual leave and "paid" sick leave to be included in this component. This however, would be inconsistent with the expense recognised under AASB 119 which is determined on an accrual basis of accounting rather than on a cash basis.
- Post-employment benefits – currently the amount disclosed under AASB 1046 relates to contributions for the period. Under ED 143, there will be no change in the amount disclosed for accumulation funds, however, for defined benefit plans, the charge under AASB 119 is not the same as the amount of contributions for the period. One approach would be to include an apportionment of all costs of the plan for the period (including interest cost, any recognized actuarial gains and losses, and the effects of curtailments and settlements). Alternatively, it could be argued that certain costs relate more to the overall costs of the plan and should not be taken into account in determining the benefits provided in exchange for services rendered by

KMP and that the amount disclosed should only include the current service cost and where applicable, any past service cost relating to that individual.

- In relation to share-based payments, AASB 1046 required amounts relating to all grants, including those attributable to pre-7 Nov 2002 grants that had not vested by 1 Jan 2005 to be included. ED 143 requires amounts relating to share-based payments to be determined in accordance with AASB 2. On initial adoption of AASB 2, AASB 1 excludes any grants made prior to 8 November 2002 from the application of AASB 2 and hence no expense would be recognized for such grants. This would mean that amounts which would be included in respect of such grants under AASB 1046 would need to be excluded under ED 143, thereby reflecting a lower value for this share-based payment component of remuneration under ED 143.
- The term "compensation" unlike the term "remuneration" does not include payments relating to services to subsidiaries. For example, where a director or executive of the parent is also required to be a director/executive of subsidiary, any payments made in relation to providing services to subsidiary will need to be excluded from compensation in the parent entity accounts. An entity would need to make an apportionment of compensation where the KMP of an entity also provide services to other entities in the group. This apportionment can be practically difficult, especially the amounts recognized for any short-tern and long term incentive plans and guidance should be provided in this area.

As stated above, we are of the opinion that Appendix 1 of AASB 1046 which duplicated the requirements of UIG 14 should be retained as it provides invaluable guidance to users of the Standard and preparers of financial statements. Similarly, the Board should consider retaining the guidance related to part-period employees, currently included in section 7 of AASB 1046.

3. Other comments

- Disclosing entities must provide details of the components of remuneration for each KMP as well as the aggregates of components for all KMP. There is an inconsistency in the application of the materiality provisions of the Standard since the individual components must be disclosed regardless of materiality whereas the aggregates are only disclosed where material.

- The deemed materiality of all director related disclosures has been removed from the former AASB 1017 for non-disclosing reporting entities. This deemed materiality should be retained, as transactions with directors are material because of their nature.

- Currently, AASB 1046 provides certain relief from providing disclosures for the comparative period. However, the requirements of ED 143 are proposed to apply to the comparative period, with no exceptions. While the removal of this exception would be considered a significant change, this has not been highlighted as a proposed change in ED 143. In addition, the effect of this does not appear to be contemplated nor correctly reflected in ED 143. For example, Appendices 3 and 4 continue to reflect the comparative exemptions provided under AASB 1046.

- We do not agree with the commentary provided in Aus 25.2.1. While it may be relevant at the grant date, events subsequent to grant date could change that assessment and AASB 2 would require 'true up' as soon as it becomes probable that service vesting conditions will not be met. As a result, this paragraph is inconsistent with the requirements of AASB 2.

- The definition of "close members of the family of an individual" includes the children of the individual and the individual's domestic partner. Children would include adult non-dependent children. It is often very difficult for a parent to know what holdings their adult children have in an entity.

- Aus 25.2 requires disclosures where the terms of equity-settled share-based payment transactions granted as remuneration to KMP are altered during the period. However, it then refers to options or rights which may be construed that the disclosures are only applicable to alterations of the terms of options or rights and no other equity-settled share-based payments. We recommend that the Board remove all references to the terms "options" and "rights" in Aus 25.4 and replace them with the term "equity settled share based payment". Users of ED 143 would then refer to AASB 2 for the definition of this term.

- The first paragraph in Appendix 5 paragraph A3.12 is repetitive of the black letter and should be removed. Similarly for the first three sentences in A5.3 – only the last two sentences which expand on the meaning of "trivial in nature" add guidance and should be retained.

- Aus 25.6.1 requires disclosure of the difference between the amount of interest paid/payable on a loan by a KMP and the amount of interest that would be charged on an arm's length basis. We recommend that the Board provide guidance as to whether this benefit is measured in accordance with AASB 119 or AASB 139.

- Aus 25.5.1(b)(vi) is repetitive of Aus 25.3(d)(iii).

- The disclosures required under Aus 16.2 of a change in KMP after the reporting date is restricted to a change upon retirement only and does not contemplate a change resulting from termination or resignation which would be of equal importance.

We would be pleased to discuss our comments further with you. Please contact Ruth Picker on (03) 9288 8620 or Georgina Dellaportas on (03) 9288 8621 if you wish to discuss any of the matters raised in this response.

Yours faithfully

Ernst & Young

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