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PricewaterhouseCoopers
ABN 52 780 433 757

Freshwater Place
2 Southbank Boulevard
SOUTHBANK VIC 3006
GPO Box 1331L
MELBOURNE VIC 3001
DX 77
Website:www.pwc.com/au
Telephone +61 2 8266 0000
Facsimile +61 2 8266 9999
Direct Phone 61 3 8603 3868
Direct Fax 61 3 8613 2308

Professor David Boymal
The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Vic 8007

16 November 2005

Dear David

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

We write in response to the request for comments contained in the September 2005 Australian Accounting Standards Board (AASB) "Exposure Draft 143: Director and Executive Disclosures by Disclosing Entities: Removal of AASB 1046 and Addition to AASB 124" (ED 143).

We support the Board's proposal to remove AASB 1046 before the end of 2005 in order to bring the director and executive disclosure requirements for disclosing entities more into line with IFRS. Our responses to the specific matters the Board has raised for comment are included in Appendix 1 to this letter. Appendix 2 to our letter provides some other comments and questions on specific drafting issues in the proposed revised standard and the Appendices to the ED.

We have some concerns with the Board's proposals relating to the compensation disclosures for key management personnel (KMP) of managed schemes. These are outlined in section A below and our more detailed response to question 13 in Appendix 1.

We also wish to raise our ongoing concern with the duplication of director and executive remuneration disclosures in Australia and our concerns with the Board's proposal to transfer some of the additional non-remuneration director and executive disclosures currently required under AASB 1046 into the revised AASB 124. These are outlined in sections B and C below.

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A: Managed schemes

We believe the Board needs to reconsider the application of the definition of compensation to managed schemes where key management personnel (KMP) are remunerated by the manager and the scheme pays management fees to the manager. Our experience to date is that applying the existing requirements of AASB 1046 causes significant practical difficulties as it requires an often subjective allocation of remuneration costs to the management of the affairs of the various schemes under management. It is often difficult to assess the meaningfulness and relevance of the resulting disclosures in the financial statements of individual schemes.

We do not interpret IAS 24 as requiring financial reports of managed schemes to disclose the remuneration of certain employees of the manager as KMP of the schemes. We are of the view that employees of managers are only provided with compensation by, or on behalf of, a managed scheme where they are determined to be KMP if an element of payments made by the scheme can be identified as being attributable to the employees' remuneration.

We are aware that some observers hold the view that governance obligations of a managed scheme are the same as those of a typical public company, and that disclosing KMP's remuneration goes some way to disclosing the cost of governance of a scheme. We disagree with this view. Managed schemes are subject to very different governance obligations to public companies, as the existence of compliance plans and compliance committees demonstrates. Further, managed schemes have no input on either the amount of remuneration or the principles applied in arriving at that amount, which is not the case for a public company.

More relevant information regarding the governance arrangements for a managed scheme might be disclosures regarding the make-up and operation of its compliance committee.

B: Duplication of remuneration disclosures

Currently, Australian listed entities are required to comply with director and executive remuneration disclosure requirements in both the Corporations Act 2001 (the Act) and Accounting Standards. This has resulted in a significant compliance burden for listed entities, as well as confusion for the users of financial reports.

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In July this year, the Corporations Amendment Regulations 2005 (No. 4) were issued to deal with the above mentioned duplicate disclosure issue. These regulations allow listed entities to transfer the remuneration disclosures required by AASB 1046 to the directors' report. However, these amendments have not resolved the issue as there are differences between the requirements of the Act and AASB 1046[1]. In addition, there is the complication of the financial report disclosures required by AASB 1046 or AASB 124 going forward needing to be audited, whereas the directors' report disclosures can be unaudited information. As a result, many of our clients have decided that transferring the AASB 1046 disclosures to the directors' report is not a workable solution and have retained two sets of disclosure.

In our view, there should be only one source of these detailed disclosure requirements relating to director and executive disclosures. The proposed removal of AASB 1046 on transition to AIFRS, with the transfer of some of its disclosure requirements into AASB 124, provides the opportunity for the Board to remove the director and executive remuneration disclosures that are above and beyond those already required by IAS 24 from the Accounting Standards. The Board could then work with Treasury to refine the Corporations Act requirements if they believed improvements were required.

If the Board proceeds with the current proposal to transfer the detailed AASB 1046 disclosures to AASB 124, we believe this should be done with the Corporations Act requirements in mind and in consultation with Treasury. The Board should seek to remove the differences in disclosure that would be retained under the proposals in the ED as they will continue to cause compliance burden for listed entities and confusion for the users of their financial reports.

C: Transfer of additional non-remuneration director and executive disclosures

In addition to director and executive remuneration disclosure requirements, AASB 1046 contains other director and executive disclosure requirements which go beyond the current disclosures required in AASB 124 and its IFRS equivalent standard, IAS 24. The Board is proposing to transfer these disclosures to AASB 124.

We do not support including these more detailed disclosure requirements in AASB 124. Some of these disclosure requirements are already included in the Act and others provide no significant benefit to users in assessing the corporate governance performance of an entity.

[1] While ED 143 does address some of these differences, the majority of them remain.

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As we have said in our previous comment letters on the international convergence exposure drafts, we strongly support the Financial Reporting Council's (FRC) policy of adopting in Australia the standards of the International Accounting Standards Board (IASB) and believe:

- Australian reporting entities must be permitted to prepare their financial reports in accordance with IFRS, as they apply to entities in other IFRS jurisdictions; and
- Australia should be adopting the International Financial Reporting Standards (IFRS) as they are written by the IASB, except in the rare circumstance where modifications are necessary because applying IFRS as written would cause contraventions of specific Australian legislative requirements.

We would welcome the opportunity to discuss our views at your convenience. Please contact me on (03) 8603 3868 or Peter Denovan on (03) 8603 6869 if you would like to discuss this further.

Yours sincerely

Jan McCahey
Partner
Assurance

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APPENDIX 1

Our responses to the Specific Matters for Comment in ED 143

1. Do you support the proposals to:

(a) remove parent relief from AASB 124; and
(b) rely on the definition of KMP and remove the requirement that the director and executive disclosures apply to the directors of the parent and at least five specified executives?

Yes, as noted in our response letter we support consistency of the disclosure requirements applicable to entities reporting under AIFRS and IFRS.

Do you consider that the removal of parent relief from AASB 124 is appropriate and sufficient to ensure IFRS compliance in respect of both parent and group entities?

Yes. As a general principle we support any changes to existing Australian reporting requirements which reduce the possibility of AIFRS compliant financial reports not complying with IFRS.

2. Do you agree with the proposal that AASB 124 be required to be applied by non-corporate for-profit entities (and not AAS 22)?

Yes. We also support the proposal that non-corporate, not-for-profit entities that are not public sector entities apply AASB 124 instead of AAS 22.

3. Do you agree that the quality and quantity of disclosing entity disclosures will not be detrimentally affected by amalgamating AASB 1046 with AASB 124?

Refer to our comments on the duplication of remuneration disclosures in section B of our letter.

4. Do you agree with the proposal to use the term KMP and remove the definitions of specified director, executive and specified executive?

Yes. As noted in our response to question 1, we support consistency of the disclosure requirements applicable to entities reporting under AIFRS and IFRS.

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5. Do you agree with the deletion of the requirement to disclose subtotals for compensation and loans for directors and non-director KMP (i.e. requiring only one KMP total)?

Yes. The sub-totals previously required were not that useful given that executive directors were required to be included in the director totals when there was a strong argument that they should have been included with the other executives. Also, again we support convergence of AIFRS and IFRS.

6. Do you agree with the proposal to delete the requirement for separate disclosure of transactions or balances with former KMP?

Yes, again we support the convergence of AIFRS and IFRS.

7. Do you agree with the proposal to delete the AASB 1046 requirement for separate disclosure of prescribed benefits in each component of the five categories of compensation?

Yes, again we support the convergence of AIFRS and IFRS.

8. Do you agree with 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)?

We do not believe the disclosures required by paragraphs Aus16.1 and 16.2 should be included in AASB 124. The Corporations Act contains some of these requirements, and we believe that AASB 124 should be restricted to what is contained in IAS 24.

9. Do you agree with the Board's proposal to incorporate section 300A(1)(ba) of the Corporations Act into AASB 124?

No. Refer to our comments on the duplication of remuneration disclosures in section B of our letter.

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However, if detailed remuneration disclosure requirements *are* included in both AASB 124 and the Corporations Act, we support them being the same to save preparers and users having to understand and reconcile the differences between the information required to be disclosed in the financial report and the directors' report. Therefore, if the Board is to continue with its current proposal, we would recommend it consider making further changes to the AASB 124 requirements to fully align them with the Corporations Act.

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"?

No. Refer to our comments on non-remuneration disclosures in section C of our letter.

11. Do you agree with the Board's proposal to delete all the Appendices to this ED when issuing the final revised AASB 124?

Yes, we believe the Appendices should be deleted as we do not believe the Board should issue Australian guidance on the application of the Australian equivalent standards to IFRS.

We have noted some comments in Appendix 2 to this letter on the drafting of the Appendices for the Board to consider if they are retained as part of, or guidance on the standard.

12. Do you consider that transitional provisions should be included in AASB 124 in respect of paragraphs Aus25.1 to Aus25.7.3, since it is the first time that disclosing entities are required to make the disclosures required by paragraphs Aus25.1 to Aus25.7.3 in respect of KMP rather than specified directors and specified executives?

No. We do not believe it is necessary to provide exemptions from disclosing comparatives for these 'new' KMP, even if the KMP differs to the directors and executives covered by the existing AASB 1046 disclosures.

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13. (a) Do you agree 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?

No. Compensation is defined in paragraph 9 by references to employee benefits and this is "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". A managed scheme does not pay or provide remuneration to employees of the manager, nor does the manager pay its employees on behalf of the managed scheme. The manager pays its employees on its own behalf for their part in carrying on the business of the manager.

The manager receives management fees as compensation for the services provided under the manager's contract. The managed scheme has not paid the employees' remuneration, but has it indirectly paid it via the management fee or has the manager just paid the remuneration on behalf of the scheme?

In assessing this question, we note that the level of ongoing management fees charged by managers is a function of a number of variables, including the level of entry and/or exit fees charged and the relative level of fees in comparable products in the market. While one of the variables may be the cost base of the manager, the overriding determinants are market forces and fee structure. In some cases ongoing management fees are nil due to the level of entry and/or exit fees. We have observed that over time management fees in basis point terms have trended down while remuneration of employees of scheme managers has not. We also note that even where remuneration of employees of a manager is linked to fees earned from the manager's services to managed funds, the remuneration is influenced by the absolute levels of fee income, rather than levels of fees being determined by remuneration.

Based on the above, we consider there is a significant (and in many cases complete) disconnect between fees paid by a managed scheme to a manager and remuneration paid to employees of a manager. Given this disconnect, we do not consider management fees paid by managed schemes can be regarded as indirectly remunerating employees of the manager nor, for the reasons outlined above, is it appropriate to regard the manager as remunerating their employees on behalf of the schemes.

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We have made enquiries of other territories including the US, UK, Ireland and certain other European funds management centres and found that in none of these centres were requirements interpreted such that related party disclosures in funds include remuneration paid by fund managers to their employees, including directors.

We believe KMP compensation disclosures in the financial statements of managed schemes should only include compensation paid by the manager in specific circumstances where the management fee arrangement can be disaggregated such that the element relating to the manager's employee costs, or part thereof, is separately identifiable and where the managed scheme bears an incremental expense for the KMP's remuneration.

13. (b) Do you 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 or should be required to make fewer disclosures, and perhaps only those required by paragraphs 1 to 22 of AASB 124?

We do not see a reason to distinguish between managed schemes and other disclosing entities for the purposes of related party disclosures. However, for the reasons outlined in our response to question 13(a) there should be no compensation to disclose under paragraphs Aus25.2 to Aus25.5.2**.**

13. (c) Do you 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)?

The managed fund industry has historically accepted that the directors of the responsible entity (or equivalent) are directors of the managed scheme (or equivalent) for the purposes of related party disclosures. This was because section 285(3) of the Corporations Act specifies that they are taken to be directors of scheme for the purposes of applying the financial report and audit provisions of Chapter 2M to the scheme.

The KMP of a manager may not be the same population of people who are the KMP of a given managed scheme. However, it seems reasonable to consider that the KMP of the managed scheme may include those persons employed by the manager who have authority and responsibility for planning, directing and controlling the activities of the scheme.

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14. Are there any other disclosure requirements you believe should be added or deleted?

Refer to our comments in sections B and C of our letter on the duplication of remuneration disclosures and the transfer of additional non-remuneration director and executive disclosures.

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

For reasons previously expressed to you, it is our view that the Australian economy is best served by having Australian standards the same as IFRS.

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APPENDIX 2

Other comments and drafting anomalies noted in ED 143

- **Paragraph Aus1.1** indicates the objective of paragraphs Aus25.1 to Aus25.7.3 is to require disclosing entities to disclose additional information relating to KMP. We believe the objective should explain *why* the additional information is required for disclosing entities, rather than stating that these paragraphs prescribe additional disclosure requirements.

- We commend the reliance of the ED on the definition contained in AASB 124 of 'close members of the family of an individual'. This is much more relevant to related party disclosures than the use of the term 'relatives' as used currently in AASB 1046.

- **Paragraph Aus25.5.4(e)** requires the equity holdings at reporting date of KMP to be disclosed. It is not clear what is required if a KMP resigns or retires during the reporting period. In our view, it is not relevant or reasonable to disclose equity holdings of former KMP after they have left the entity's employment, so the balance disclosed under this paragraph would be nil, with the adjustment being included as "any other change" under Aus25.5.4(d). We believe guidance should be included to make this clear.

- **Paragraph Aus25.5.4(f)** refers to equity holdings held "nominally". We have had many questions from clients as to what this actually means (in the context of the equivalent requirement in AASB 1046) and strongly encourage the AASB to include some guidance on this.

- **Paragraph Aus25.7** - the first sentence is worded as if the disclosure requirements that follow are required for each individual KMP, but it seems from the rest of the paragraph that only aggregate disclosures are required. If this is correct, we suggest the first sentence of Aus25.7 should start as follows: "In respect of transactions during the reporting period between the disclosing entity and any of its subsidiaries and ~~each~~ key management person*nel*, including….".

- **Paragraph Aus9.1.1** indicates "...all references in the Corporations Act to the remuneration of directors is taken as referring to compensation…". Should this say "...all references in the Corporations Act to the remuneration of directors *and executives*…"?

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- **Appendix 2:** The 20X6 numbers for the 'share-based payment' column and the 'total' column in Table 2.1 do not add. Also, both columns in Table 2.2 do not add. Please note, we have not checked all adds, so there may be other errors in the tables.

- **Appendix 4:** The last column in the top section of Table 5 contains the numbers 6,000 and 7,000. Our understanding is that this disclosure is the number of KMP included in the aggregate loan disclosures (in accordance with paragraph Aus25.6.1(g)) so the numbers 6,000 and 7,000 are unrealistic.

- **Appendix 4:** The last column in the bottom section of Table 5 is headed "In group 31 Dec X6". Our understanding is that this column is disclosing the highest amount of indebtedness during the reporting period for each KMP (in accordance with paragraph Aus25.6.1(f)). If this is the case, the column heading is incorrect.

- **Comparatives:** There are no specific paragraphs in the ED dealing with the need for comparatives. We assume therefore that AASB 101 paragraph 36 applies and comparatives are required "for all amounts reported in the financial report". If this is the case we are confused about two comments in the second paragraph of Appendix 4 which state that certain comparatives are not required. If the Appendices are to be deleted, how would preparers know that these comparatives were not required? The specific comments we are referring to are: "Disclosure on an individual basis is required only when the aggregate loan of a key management person exceeded $100,000 during the reporting period **and comparative amounts are not** required even if that individual was classified as key management personnel in the preceding reporting period. For the group aggregate for key management personnel, disclosure of comparative amounts is required **but not** the highest amount outstanding during the reporting period". We have the same comment in respect to the last sentence of paragraph A4.2 of Appendix 5: **"Comparative amounts are not required** in respect of personal aggregates".

- **Appendix 5:** Paragraph A2.1 refers to "The details required by Aus25.3(c)…". This should read: "The details required by paragraph Aus25.3(e)…". Also, a number of the items mentioned in this paragraph (such as the length of notice), are specifically covered by paragraph Aus25.3(h).