

## ASIC CLASS ORDER [CO 06/105]

### EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

*Corporations Act 2001*

Subsection 341(1) - Order

Subsections 341(1) of the *Corporations Act 2001* (the Act) provides that the Australian Securities and Investments Commission (ASIC) may make an order in respect of a specified class of companies, registered schemes or disclosing entities that relieves the entities in question, their directors and/or auditors from specified requirements of Parts 2M.2, 2M.3 or 2M.4 (other than Division 4) of the Act.

#### **1. Background**

There are two separate sets of requirements for the disclosure of information on director and executive remuneration in annual reports of listed companies:

- (a) section 300A of the Act requires disclosure of information in the directors' report by listed companies; and
- (b) accounting standards having the force of law under s.296(1) of the Act require disclosure of information in the financial report.

Regulation 2M.3.03 continues to require the measurement requirements of accounting standard AASB 1046 "Director and Executive Disclosures by Disclosing Entities" (AASB 1046) to be applied for the purposes of disclosing remuneration of directors and executives in the directors' reports of listed companies in accordance with s.300A(1)(c).

On 20 December 2005, the Australian Accounting Standards Board (AASB) issued a new accounting standard dealing with disclosure of director and executive remuneration and transactions by disclosing entities. The new AASB 124 "Related Party Disclosures" (the new AASB 124) replaced AASB 1046 for years ending on or after 31 December 2005 for the purposes of s.296(1), but not for the purposes of s.300A(1)(c). Unlike AASB 1046, AASB 124 doesn't contain requirements for measuring remuneration.

ASIC took the view that because AASB 124 doesn't specify a basis for measuring remuneration, it would be possible to make both the disclosures under s.300A(1)(c) and the new AASB 124 using the measurement basis in AASB 1046. This measurement basis has been used in the past, provides a ready source of comparative information, and continues to be used by at least some companies.

While AASB 2 "Share-based Payment" (AASB 2) and AASB 119 "Employee Benefits" (AASB 119) can provide useful guidance for measuring remuneration, they are intended for determining expense and income relating to groups of employees. Their measurement requirements should be applied with modifications to more suitable for disclosing remuneration. This would result in a measurement basis closer to, or the same as, that in AASB 1046.

However, ASIC subsequently become aware that some held the view that AASB 124 requires a strict application of the measurement basis for expenses and income in accounting standards AASB 2 and AASB 119 in measuring remuneration. Some companies may also have applied the AASB 2 and AASB 119 measurement requirements but with some modifications.

The strict AASB 2/AASB 119 measurement basis differs in some respects from the basis required by AASB 1046. For example, for the value to be included in relation to options it is not necessarily assumed that employees will meet service based vesting conditions, and any amounts recognised in prior years can be reversed if service based vesting conditions aren't met. For members of defined benefit superannuation funds, actuarial gains and losses recognised in relation to the fund are relevant rather than contributions.

## **2. ASIC Class Order [CO 06/105] “Calculation of director and executive remuneration”**

ASIC Class Order [CO 06/105] “Calculation of director and executive remuneration” will allow listed companies to apply either of the following for the purposes of disclosing an individual’s director and executive remuneration in accordance with s.300A(1)(c) and paragraph Aus25.4 of AASB 124 for years ending 31 December 2005 to 31 March 2006 (both inclusive):

- (i) The measurement requirements, categories of remuneration and definition of “remuneration” in AASB 1046 (the AASB 1046 basis); or
- (ii) The measurement bases in AASB 2 and AASB 119 (but which may be modified as is reasonable to apply those bases to the disclosure of compensation of individuals), the categories of compensation in AASB 124 and the definition of “compensation” in AASB 124.

The relief is conditional on:

- (i) the same measurement basis, categories and definition being used for all of the relevant disclosures; and
- (ii) the directors’ report includes a narrative explanation of any differences from using the AASB 1046 measurement basis.

[CO 06/105] provides short term relief to assist listed companies by addressing potential confusion as to the bases for calculating remuneration of directors and executives for disclosure in directors’ reports and financial reports. The relief will remove any doubt over the ability of companies to meet all of the disclosure requirements in relation to an individual director or executive’s remuneration using a single measurement basis.

The relief is of an interim nature. The Government is considering the operation of the regulations affected by the replacement of AASB 1046 by the new AASB 124. ASIC intends to cease providing relief in relation to the disclosure of director and executive remuneration when the regulations are amended.

ASIC recognises that the relief may result in some short-term reduction in comparability of remuneration information between listed companies, but the relief is short term and all listed

companies using the relief will be required to disclose the nature of differences in their measurement basis from the AASB 1046 basis.

In adopting the measurement bases in AASB 2 and AASB 119, companies may apply such modifications as are reasonable to apply those bases to the disclosure of compensation of individuals. This should result in the adoption of a basis closer to that in AASB 1046. For example, a company may choose not to reverse prior year remuneration in relation to options in the year that service based vesting conditions are not met.

#### Aggregate disclosures under AASB 124

The relief doesn't extend to the aggregate remuneration disclosures under paragraph 16 of AASB 124. Listed companies adopting the AASB 1046 basis for their disclosures by individual may wish to be aware that some hold the view that the aggregate disclosures required by AASB 124 must be determined on a strict AASB 119/AASB 2 approach to ensure convergence with IAS 24. Those holding that view would suggest that this should also drive the basis for measuring and disclosing remuneration of individuals.

#### Transfer of disclosures

In January 2006, ASIC issued Class Order [CO 06/50] "Transfer of remuneration information into directors' report" which allows listed companies to transfer the AASB 124 individual remuneration information from the financial report into the directors' report where the s.300A(1)(c) disclosures reside.

[CO 06/105] includes provisions to allow information presented in substitution for the AASB 124 information to be transferred into the directors' report, subject to meeting similar requirements to those in [CO 06/50]. These requirements include a requirement for a specific audit opinion in relation to transferred information prepared in accordance with the class order.

### **3. Consultation**

As [CO 06/105] is minor and machinery in nature, ASIC did not undertake any consultation with stakeholders before that class order was made.