Senate Economics Legislation Committee

Inquiry into the Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002

Submission No. 5

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The Secretary
Senate Economics Committee
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Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Secretary

Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002

CPA Australia and The Institute of Chartered Accountants in Australia (the Accounting Bodies) appreciate the opportunity to make this submission on the *Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002* (the "Amendment Bill"). The submission has been prepared by our Legislation Review Board under the administration of our Australian Accounting Research Foundation. The Board is appointed to advise on matters of legislative and regulatory policy affecting financial reporting, auditing and corporate governance.

We support inclusion of improved provisions in the *Corporations Act 2001* (the "Act") covering payments to directors. However, we believe the Amendment Bill should address the granting of benefits (including bonuses) to directors (and others such as chief executives); the recovery of unreasonable payments; and protect the interests of shareholders as well as creditors.

Though the impetus for the amendments was the recovery of bonus payments to directors, we believe that the amendments should first address the granting of bonuses and other benefits to directors and senior executives and consider the interests of creditors and shareholders. If this were done, then special provisions relating to voiding payments of bonuses and other payments as distinct from payments in general may not be needed.

As an example of the limitations of the Amendment Bill, consider the following situation. A company (such as a parent company) appoints one of its directors (and/or employees) as a director of another company (such as a subsidiary) and the parent company makes payment to the individual linked to that individual's role with the subsidiary. The liquidator of the subsidiary would be unable to treat the parent company payments as an "unreasonable director - related transaction" as the subsidiary company the liquidator is administering has not made the payment. Payments (say part of a management fee) to the parent company might be voidable by regarding them as in the nature (at least in part) of a payment to a director is covered by the Amendment Bill. However, how the amount could be separated out of a general payment may present some issues. Where no payments have been made

other than dividends, voiding of such dividends/payments (in full or part) to the parent company while leaving dividend payments to other shareholders intact raises equity issues. Where no payments have been made, the company in liquidation has no payments to void but the parent company has an issue regarding its payments to directors/executives.

We believe that bonuses and other benefits to directors (and senior management), including performance hurdles for payment and severance arrangements, should be subject to disclosure (beyond that required by Part 2M.5 of the Act and Accounting Standard AASB 1017 'Related Party Disclosures') to include the likely cost at the time the transactions are incurred [approved] with at least annual updates of the likely eventual cost and approved by shareholders. This would avoid the surprises to the market that have been occurring when the previously unknown magnitude of the payments have eventually been disclosed to the market. Then such incurred transactions should not be voidable under the Amendment Bill. Otherwise, directors and senior management may press for earlier payment so any subsequent and non-immediate change of circumstance would not increase the risk that delayed payments may be reassessed as voidable based on more recent and adverse circumstances.

We also believe that payments to directors that might be subject to voiding should exclude directors' basic remuneration and be limited to bonus and severance payments beyond a threshold, which should relate to factors that vary based on features of companies and their industries (a policy decision for government). However, if the shareholders have approved the bonus and severance payment agreements when the company was solvent, the payments should not be subject to voiding under the Amendment Bill. We believe that, unless there is a compelling case, the voiding of payments provisions should apply to all companies (i.e., including those operating normally and those under administration) and not just insolvent companies under external administration as envisaged in the Amendment Bill.

The Amendment Bill implies by its title that it relates only to bonus payments to directors whereas the unreasonable director-related transaction provisions are not restricted to just bonus payments. The broader reach of the amendments is generally supported. Director related payments, not just bonuses, should be subject to scrutiny to ensure they are reasonable and have received appropriate approval. However, if the incurring of the payments is appropriately approved (by shareholders) then the transactions should not be voidable just because, in hindsight, the payments should not have been approved, particularly when the changes are normal risks that should have been considered when the payments were incurred. For instance, we do not believe it to be reasonable to void a director's right to payment for a debt due arising from the director having previously sold his business to the company when shareholders have approved the acquisition and the view at that time was that the acquisition was reasonable. To permit voiding in such situations would unfairly and adversely affect directors' actions and could adversely affect business confidence.

Also, it would seem that someone who was not a director when a payment was incurred but subsequently was a director when the payment was entered into would be subject to the proposed amendments. It is unclear whether this situation was contemplated when the Amendment Bill was drafted.

The proposed subsection 588FF(4) limits the court to make orders "... only for the purpose of recovering for the benefit of the creditors ...". In the event that creditors' entitlements are already covered and therefore the creditors are not entitled to any further payment, the

proposed subsection would seem to be stating that an otherwise unreasonable director-related transaction would not be voidable. This would be notwithstanding that shareholders have lost the value represented by the unreasonable director-related transaction. In other words, the proposed subsection specifically provides and endorses the fact that once creditors interests are addressed, then the amendments related to unreasonable director-related transactions cease to have application. It disregards the interests of shareholders.

We would welcome the opportunity to discuss with you our submission or other matters on which you would like our views or additional input. Please direct any queries to Mr Stan Neild, Manager Legislation Review, on (03) 9641 7439.

Yours sincerely,

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