



# REMUNERATION UPDATE REMUNERATION UPDATE

AUGUST 2004

This Newsletter re-visits the contentious issue of performance based Non-Executive Director's Remuneration.

We look at the impact of changes to income tax rates which came into effect on the 1<sup>st</sup> July, 2004 and the impact of further changes to take place on the 1<sup>st</sup> July, 2005. We also consider possible changes in public sector remuneration practice.

## Remuneration Practice for Non-Executive Directors in Australia

In the July, 2004 issue of Company Director Eric Janson again raises the contentious issue of performance based remuneration for non-executive directors and board members.

At the heart of the discussion is the role played by non-executive directors. Janson maintains that, over the last three years, there has been a strong emphasis on corporate governance. Directors are required to ensure that companies meet their statutory and legal requirements and act in ways that accord with broader community expectations.

No one disputes the need for good corporate governance. But Janson asserts that it has been achieved at the cost of Board encouragement for risk taking and entrepreneurial behaviour in organisations:

'One could argue that the end result of this compliance focus is a deeply conservative board - fundamentally risk-avoiding, with a collective inclination to retard rather than reward sensible and much needed commercial risk taking. This way of thinking stifles the company's ability to engage in responsible "entrepreneurial" behaviour.'<sup>1</sup>

Whilst this is certainly true of some Boards our experience in small to medium organisation suggests an alternative perspective. Most non-executive directors are concerned to 'add value' to the organisations on whose Board they sit. Directors are selected because of their industry and/or specialist expertise and Chairmen in particular, are concerned to ensure that this expertise finds its way into the organisation.

Directors regularly participate in business planning forums, committees to look at specific business issues and act as mentors to CEOs and other executives.

### *Remuneration Practice*

If we accept that non-executive directors have a dual role of ensuring compliance and adding value to the organisation then we need ask the question as to whether existing executive director remuneration practice is appropriate.

<sup>1</sup> Sharing Risks and Rewards. Eric Janson. Company Director Vol 20 No 6 July 2004 pp 14-16.

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Remuneration practice for Australian non-executive directors usually provides for fixed annual remuneration based upon company size, industry group and the general remuneration market. There has been considerable discussion about linking part of director's remuneration to overall organisation performance. So major corporates offer directors the opportunity to participate in share and option plans.

A range of factors are taken into account when establishing remuneration level for non-executive directors in Australia:

- The remuneration market for directors as measured through various remuneration surveys;
- The director's role on the Board such as Chairperson, Deputy Chairperson, Committee Member;
- Organisation type such as listed public company, private company, mutual society, government business enterprise, statutory authority;
- Organisation size as measured by gross turnover, value of assets, earnings before interest and tax or overall budget.

Remuneration practice for non-executive directors has generally been to offer a flat fee on a per annum basis in much the same way as salaried employees. Some companies require the director to salary sacrifice the Superannuation Guarantee Charge. Others pay it in addition to the directors fees.

Some government organisations pay board members and non-executive directors on a sessional basis.

According to the latest RPC Top 500 Report only 1% of chairman and 2% of other non-executive directors received a short term incentive payment in 2003. This is essentially unchanged from the previous year.

The ASX 'Principles of Good Corporate Governance and Best Practice Recommendations' March 2003. *Principle 9 Remunerate Fairly and Responsibly* addresses the issue of directors remuneration. It contains two seemingly contradictory statements:

'The company should design its remuneration policy in such a way that it:

- Motivates directors and management to pursue the long term growth and success of the company within an appropriate framework.'

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And yet further in Box 9.3: Guidelines for non-executive director remuneration

1. Non-executive directors should normally be remunerated by way of fees; they should not participate in schemes designed for the remuneration of executives.
2. Non-executive directors should not receive options or bonus payments.

Jason concludes his article by encouraging directors to seek out opportunities to ensure that they share the risks that shareholders take in investing in a company. We support this notion and believe it is only a matter of time before the introduction of performance component is again considered in terms of director's remuneration

### **Income Tax Changes**

On the 1<sup>st</sup> July, 2004 new income tax rates came into effect. Further changes are scheduled for 1<sup>st</sup> July, 2005.

These changes effectively raise the income levels at which the higher income tax rates cut in. The following tables illustrate:



**Tax Rates 2003-2004**

Taxable Income	Tax Payable
\$0 - \$6,000	Nil
\$6,001 - \$21,600	\$0.17 per \$1 over \$6,000
\$21,601 - \$52,000	\$2,652 plus \$0.30 per \$1 over \$21,600
\$52,001 - \$62,500	\$11,772 plus \$0.42 per \$1 over \$52,000
Over \$62,500	\$16,182 plus \$0.47 per \$1 over \$62,500

**Tax Rates 2004-2005**

Taxable Income	Tax Payable
\$0 - \$6,000	Nil
\$6,001 - \$21,600	\$0.17 per \$1 over \$6,000
\$21,601 - \$58,000	\$2,652 plus \$0.30 per \$1 over \$21,600
\$58,001 - \$70,000	\$13,572 plus \$0.42 per \$1 over \$58,000
Over \$70,000	\$18,612 plus \$0.47 per \$1 over \$70,000

**Tax Rates 2005-2006**

Taxable Income	Tax Payable
\$0 - \$6,000	Nil
\$6,001 - \$21,600	\$0.17 per \$1 over \$6,000
\$21,601 - \$63,000	\$2,652 plus \$0.30 per \$1 over \$21,600
\$63,000 - \$80,000	\$15,072 plus \$0.42 per \$1 over \$63,001
Over \$80,000	\$22,212 plus \$0.47 per \$1 over \$80,000

As Australia has progressive taxation an individual's effective tax rate will always be less than the marginal tax rate.

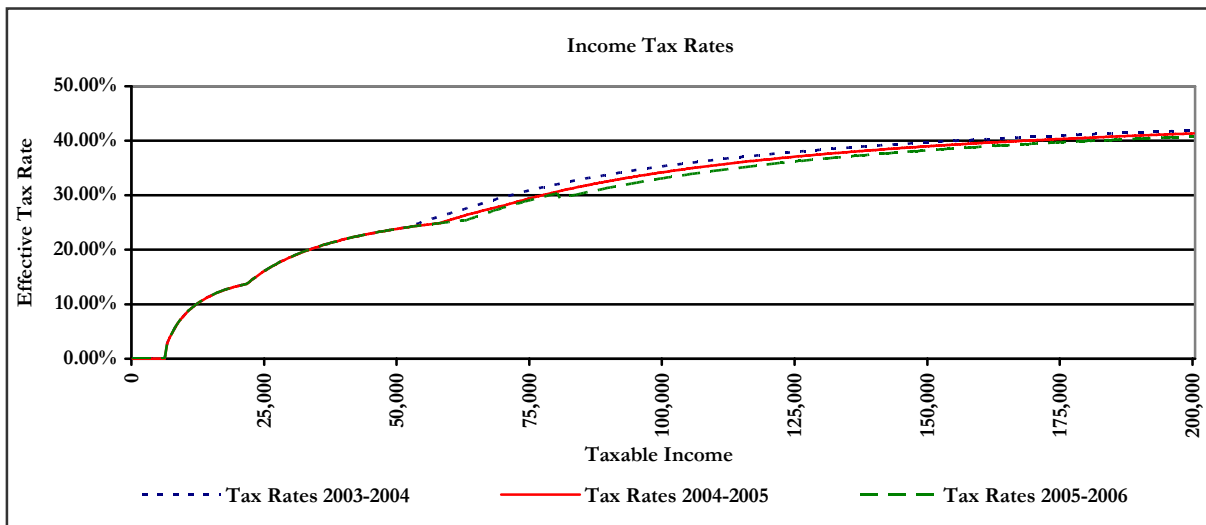
The graph below illustrates effective tax rates up to \$200,000 pa.

**Remuneration Packaging**

The reduction in tax rates for those earning above \$52,000 pa indicates that some staff may need to review the structure of their remuneration package. Staff who have packaged benefits which attract the top FBT rate may be well advised to cash out those benefits.

Likewise those that have packaged motor vehicles should carefully consider their effectiveness. Motor vehicles are an expensive capital item and packaging may confer some taxation advantage. However staff members need to consider whether they are making the best use of their remuneration. For instance moving to a more modest vehicle and increasing superannuation contributions may be a wiser proposition.

If your human resources group has the facility to run package scenarios it may pay consider a few options. If not your accountant will be able to do this for you.





## **Are We Seeing A Return To Traditional Remuneration Structures in the Government Sector?**

Over the last fifteen years many commonwealth, state and local government organisations moved away from traditional narrow banded fixed incremental remuneration structures. Taking the lead from their private sector colleagues many have embraced broad banded structures with performance based progression. Many have also introduced short term incentive (STI) plans.

Some government owned organisations, particularly government business enterprises (GBEs) and statutory authorities have flourished with performance oriented structures and delivered sound returns to government and customers.

In concert with these changes to remuneration practice most government sector organisations have moved to fixed term employment contracts for executives. Terms vary between three and five years and most provide the option to renew at the expiry of the term if there is agreement between the parties.

Recent press coverage has suggested that performance based remuneration structures and fixed term contracts have contributed to a bureaucracy reluctant to provide fair and impartial advice to ministers. This assertion remains untested.

Over the last twelve months there have been a number of developments that signal a potential shift in government thinking on remuneration. Some examples are as follows:

- In early 2004 the State Government of Victoria replaced its five level broad banded structure with six level structure for non-executive staff. This new structure re-introduced fixed annual increments.

- Early in 2004 the State Government of Victoria cashed out 3% of the incentive opportunity for public sector executives. This resulted in the STI ceiling being reduced from 20% to 17% of package. A similar move is under active consideration for executives employed in GBEs and statutory authorities.
- On August 9 the Federal Labor Party released a policy aimed at winding back public sector reform at the Federal level. Amongst other changes the policy seeks to abolish performance based bonus for senior bureaucrats, extend contract terms from three to five years unless special circumstances prevail and strengthen security of tenure.

Some executives and human resource specialists are watching these developments with a sense of disquiet. Many believe that changes in employment and remuneration practice in government sector organisations have had a positive impact on organisation culture and performance.

Many government organisations now rigorously track performance against a range of measures which span all facets of the organisation. Boards track performance. Board Remuneration Committees overview executive remuneration and ensure appropriate processes are followed in setting levels. They also ensure STI payments accurately reflect performance.

In our view it would be a retrograde if advances in government sector thinking about remuneration and related performance and contract management were wound back or unwound altogether. Many of us remember the dampening impact of fixed incremental structures on performance.



### **Corporate Sponsorship**

In 2002 Geoff Nunn & Associates embarked on a special project to develop an historic racing car as a business development activity. Through our work with the previous General Manager, Victoria of Chandler & Macleod, Job Bate, we knew that historic motor sport was becoming increasingly popular with managers and executives.

After considering various options we chose to sponsor the development of a 1966 Datsun Sports Roadster. A suitable vehicle was located in Geelong and a development plan formulated. The vehicle was to be prepared in strict accordance with CAMS Group Sb regulations. Various specialists were assigned tasks to build the relevant components and assemble the vehicle in readiness for racing.

After much hard work and trial the vehicle is almost ready to compete in competitive motor sport.



*Brian Tuckett, Remuneration & Benefits Manager of Sensis Pty Ltd fine tunes the vehicle during a race practice day at Winton, Victoria.*

Our first competition event took place at the Morwell Hillclimb on 1<sup>st</sup> August, 2004 with a very credible best time of 42.23 seconds.

Preparations are well advanced for entry in the Tattersall's Historic at Sandown Motor Raceway 13<sup>th</sup> and 14<sup>th</sup> November, 2004. Watch this space for updates

### **About Geoff Nunn and Associates**

Geoff Nunn & Associates was established in Melbourne, Australia in 1993. Since then, the Company has established a reputation for professionalism and quality service. Projects have been completed in over 650 organisations across Australia.

### **Our Services**

- **Remuneration Strategy Development.**
- **Job Evaluation**
- **Market Remuneration Advice.**
- **Remuneration Packaging.**
- **Board Remuneration.**
- **Performance-Based Incentives.**
- **Remuneration Management Software.**
- **Competency Modelling and Profiling.**
- **Balanced Scorecard Performance System.**
- **Organisation Structuring and Design.**
- **Contracts of Employment.**

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