



# REMUNERATION UPDATE REMUNERATION UPDATE

FEBRUARY 2005

This Newsletter focuses on changes to the Corporations Act which came into effect for listed companies from 1<sup>st</sup> July, 2004 (part of the CLERP 9 amendments).

We also consider market movements over the past twelve months and review the new National Remuneration Centre on-line salary survey facility.

## CLERP 9 And Its Implications

The *Corporate Law Economic Reform Program (Audit Reform and Disclosure) Act 2004* (CLERP 9) requires that the directors' annual report to shareholders includes a 'remuneration report' covering the following:

- Board policy on the remuneration of directors and executives.
- The relationship between board remuneration policy and company performance.
- Details of any performance related component of remuneration, measures used and the method by which these are assessed.
- The details of remuneration for each director and the top five executives. This should include a breakdown of the components of remuneration (ie base salary, superannuation, motor vehicle). It should also include details short and long term incentives.

A resolution must be put to shareholders that the Remuneration Report be adopted. Shareholders vote on acceptance (or non-acceptance) of this report is 'non-binding'. In other words the directors do not have to accept the vote of shareholders.

The remuneration report needs to be framed in such a way as to ensure ease of understanding, have the appropriate level of transparency and be able to withstand intense scrutiny. Some shareholders will not be well versed in issues of remuneration strategy. So a thorough explanation of terminology and processes is required.

These changes have significant implications for the way in which remuneration committees, and boards generally, go about setting board and executive remuneration policy. A number of imperatives are clear:

- The Board must have access to accurate remuneration market information. A job evaluated source is preferable as it provides a higher level of accuracy. Position match data does not readily account for organisation and position differences.
- Careful consideration needs to be given to market positioning. The Board must ensure that market positioning reflects company performance and capacity to pay. Shareholders are unlikely to be impressed with a remuneration policy which targets the third quartile when performance is running at the first quartile.

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- The 'At Risk' components of remuneration must be linked to clear measures of company performance. These measures should include financial and non-financial targets. In this way shareholders can be assured that business fundamentals, long term sustainability and growth are key components of the company's performance strategy and will be rewarded accordingly.

Shareholders will be concerned to see that the company is exercising restraint in remuneration and not offering overly generous packages to directors and executives in times when shareholder returns are low. As a general rule the quantum of remuneration packages should be sufficient to attract and retain capable executives without being excessive in market relativity terms. Recent press coverage has made some shareholders extremely sensitive to what they perceive to be excessive executive remuneration levels.

The same cannot be said for non-executive director remuneration levels. Many argue that directors, in all but the largest companies, are inadequately remunerated for their level of accountability and increased corporate governance workload.

The need to table a remuneration report as part of the annual report process raises the interesting question as to how directors should respond in the event of a negative vote by shareholders. As the shareholder's vote is non-binding the board may accept, partially accept or reject the view of shareholders.

If the board accepts, or partially accepts the views of shareholders it may need to re-visit aspects of the remuneration policy and make the necessary adjustments. This may be difficult, particularly where changes compromise existing executive contracts. Where the organisation has contracted to remunerate executives at specified level any withdrawal from that agreement, to mollify shareholders, may result in a legal dispute with the executives in question.

If the Board rejects the view of shareholder it may be appropriate to provide a detailed explanation setting out the reasons for the rejection. According to the most recent edition of Company Director some directors would view a vote against the remuneration report as a vote of no confidence in the board.

The other vexed question with regard to increased disclosure requirements is its impact on the executive remuneration market. For some time critics of greater disclosure have argued that it fuels the market as executives compare their remuneration with professional peers. Whilst this no doubt occurs, in our experience boards generally take a conservative stance with respect to executive remuneration.

Some information for this article has been sourced from the Australian Institute of Company Directors paper *'Shareholder Consideration of Annual Remuneration Report of a Listed Company: A Guide for Consideration of the Issues'*. 2004.

The rules set out in CLERP 9 apply only to listed companies. We believe however many other organisations will follow suit and include a remuneration report as part of their annual report.

**Geoff Nunn & Associates** specialises in providing advice and service to Boards in relation to issues of board and executive remuneration. These include:

- Job evaluation and market remuneration advice on board and executive roles;
- The development of board and executive remuneration policy;
- The development of short term executive incentive plans;
- Preparation of the annual remuneration report.



### **Elements of An Integrated Executive Remuneration Strategy**

A well designed and integrated executive remuneration strategy will include the following items:

1. A clear statement of policy intent.
2. The mechanism by which job size for executive roles is determined, that is, the job evaluation system utilised.
3. How job size is linked to market remuneration data and the remuneration databases utilised.
4. The effective fixed remuneration range for each executive position and the mechanism by which remuneration progression is achieved.
5. The rules regarding remuneration packaging.
6. The structure of any short term incentive plan including incentive targets and ceilings. This should include the process for setting and reviewing corporate and business unit targets. It should also specify the rules governing the plan.
7. The structure of any long term incentive plan including the mechanism for issue of performance shares and options. This should also include the process for setting and reviewing strategic corporate targets and any comparator benchmarks. It should also specify the administrative guidelines of the plan.

We do not suggest all of the above detail needs to be included in the Annual Remuneration Report. However Boards will be looking to ensure all aspects executive remuneration policy are documented and defensible.

### **The National Remuneration Centre Moves Its Surveys On-Line**

Effective from the 3<sup>rd</sup> November, 2004 our close colleagues at the National Remuneration Centre (NRC) took their flagship 'All Industries' job evaluated survey on-line. A hard copy version will no longer be available.

This move follows the trend of other survey providers. The major difference however, is that the NRC publishes regression equations and trendline graphs for different occupational groups. Savvy users can track trendline movements over a period of time. This gives a true indication of market movement.

Some of the features of the on-line survey include:

- It covers nearly one hundred positions all of which are graded by occupational group and job size.
- Formulae and trendlines are provided for each occupational group.
- Same incumbent market movements are provided by occupational group.
- A comprehensive economic commentary.

Geoff Nunn & Associates utilises NRC job evaluation systems and databases (along with other data sources) in our consulting work.

According to the most recent survey Total remuneration moved 4.5% for the 12 months to 30<sup>th</sup> September 2004. Predicted movement for the 12 months to 30<sup>th</sup> June, 2005 is 4.25%.

### **Awards Return to the State of Victoria**

Effective from the 1<sup>st</sup> January, 2005 a number of Federal Awards will apply to some organisations that were previously award free in Victoria. For instance the Clerical & Administrative Employees (Victoria) Award 1999 has been declared a 'Common Rule Award' for many employees involved in clerical work throughout Victoria. Other Awards are similarly expected to be declared common rule.

These awards will specify minimum terms and conditions.

All organisations are encouraged to contact VECCI or their industry association to ascertain if they are affected by these changes.



### **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 Philosophy**

- ❑ As professional providers, the highest standards of service delivery and quality apply.
- ❑ Depth of expertise is critical in any field of professional endeavour. Our consultants and associates are all professionally qualified and specialists in their fields.
- ❑ Independence increases the options available for addressing organisational problems.
- ❑ Each organisation's operating environment is unique. This uniqueness suggests the need to tailor specific solutions rather than rely on generic approaches.
- ❑ All stakeholders should share in the risks and rewards associated with organisational performance.

### **Our Services**

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

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