Deloitte.

Disclosure of remuneration
- a hot topic

Next

Remuneration of directors is increasingly one of the most hotly debated topics in the corporate governance arena, due mainly to some infamous recent examples and the resultant tension between shareholders demanding to understand and to be able to rationalise their directors' remuneration levels and methods, and the directors' desire for privacy in their financial affairs.

In terms of the Companies Act, 2008 companies should provide full disclosure of each individual executive and non-executive director's remuneration in the Annual Financial Statements of the company, giving details as required in the Act of base pay, bonuses, share-based payments, granting of options or rights, restraint payments and all other benefits (including present values of existing future awards). Similar information should be provided for the prescribed officers of the company.

The International Integrated Reporting Framework, issued by the International Integration Reporting Council indicates that the Integrated Report sets out how the remuneration of directors is linked to performance in the short, medium and long term, including how it is linked to the organisation's use of and impact on the resources and the development and maintenance of relationships on which it depends. In other words, the Integrated Report should contextualise the remuneration as disclosed in the Annual Financial Statements.

What is required here is not necessarily only the disclosure of the total remuneration paid to the directors and prescribed officers of the company, but it should include an explanation, in plain and understandable language, of how remuneration is used to ensure that directors deliver on the key performance indicators linked to the strategic objectives of the company.

A key challenge in this regard is to ensure that the Integrated Report illustrates the link between the strategic objectives of the company, the key performance indicators, the remuneration policy and the way in which the remuneration package of each director and prescribed officer is determined. The Report should explain to the reader the utilisation of base pay, bonuses, and short and long term incentives in relation to the performance of the company/directors with respect to both financial and non-financial performance indicators.

The director's right to remuneration

Both executive and non-executive directors provide services to the company for which they are entitled to be remunerated. Executive directors generally enter into an employment contract in which their remuneration is agreed upon. In many cases, non-executive directors have no formal contract with the company but are paid a standard level of fees for attending board and committee meetings.

The Memorandum of Incorporation of a company generally provides for the remuneration of the directors, both for the services they provide as directors and any expenses that they incur on behalf of the company.

Except where the company's Memorandum of Incorporation provides otherwise, the Companies Act determines that the directors are entitled to remuneration for their services as directors only if such remuneration is authorised by a special resolution approved by the shareholders within the preceding two years. In this regard it is important to distinguish between remuneration paid to directors in terms of an employment contract (in the case of executive directors), and remuneration paid for services as directors. In terms of the Companies Act, shareholder approval is only required for the latter.

With respect to the special resolution approving the remuneration to directors for their services as directors, the resolution may be phrased widely to provide parameters within which the remuneration committee may calculate the exact amounts. It is therefore not necessary to obtain shareholder approval for each payment to a particular director. This approach is in line with the principles as set out in King III.

Remuneration policy

King III suggests that the remuneration committee be tasked with setting and administering remuneration policies in the company's long-term interests. The committee should consider and recommend remuneration policies for all levels in the company, but should be especially concerned with the remuneration of senior executives, including executive directors, and should also advise on the remuneration of non-executive directors.

> *"In proposing the remuneration policy, the remuneration committee should ensure that the mix of fixed and variable pay, in cash, shares and other elements, meets the company's needs and strategic objectives. Incentives should be based on targets that are stretching, verifiable and relevant. The remuneration committee should satisfy itself as to the accuracy of recorded performance measures that govern vesting of incentives. Risk-based monitoring of bonus pools and long-term incentives should be exercised to ensure that remuneration policies do not encourage behaviour contrary to the company's risk management strategy."*
>
> – King III Report principle 2.15 par 151

King III proposes that the remuneration policy of the company be approved by shareholders, and that the board should be responsible for determining the remuneration of executive directors in accordance with the approved remuneration policy. It is recommended that the remuneration committee set well-defined criteria against which individual directors should be assessed. Directors often have a number of directorships within the same group, some executive and some non-executive. It is therefore not unusual for an individual to receive emoluments in various forms and from various sources.

What type of remuneration is appropriate? Remunerating directors can take a number of forms, and there is on-going debate as to the most appropriate way of both compensating the director for his or her time, and aligning their interests with the long term interests of the company they serve. It is unusual for a remuneration policy to employ only one type of remuneration and often a variety of different remuneration methods are negotiated.

Companies Act requirements

Section 30(5) of the Companies Act requires that the disclosure of the remuneration of each director and prescribed officer in the Annual Financial Statements of the company

"… must show the amount of any remuneration or benefits paid to or receivable by persons in respect of

(a) services rendered as directors or prescribed officers of the company, or
(b) services rendered while being directors or prescribed officers of the company
  (i) as directors or prescribed officers of any other company within the same group of companies, or
  (ii) otherwise in connection with the carrying on of the affairs of the company or any other company within the same group of companies."

The effect of these requirements is that all remuneration paid to or receivable by a director or prescribed officer must be disclosed. Thus, not only the remuneration paid to or received by the director or prescribed officer for services to the company, but also all other remuneration received by the director or prescribed officer for services rendered as a director or prescribed officer to any other company with the group, or in connection with the carrying on of the affairs of the company. One person's remuneration may have to be disclosed by more than one company in the same group of companies.

Consider the following: Company B is a subsidiary of Company A. Person X is a director of Company A, and is also a prescribed officer of Company B (as he takes decisions that, in his capacity as director of the holding company, impacts the subsidiary to such an extent that it constitutes executive management or control with respect to the subsidiary). He receives remuneration from company A, but is not paid by Company B for any of the services rendered to Company B. In terms of the requirements as set out above, his remuneration for services as a director of the company (Company A) must be disclosed in the annual financial statements of Company A (see Section 30(5)(a) above). If one regards the position from the perspective of the subsidiary Company B, the remuneration paid to person X by Company A will also have to be disclosed in the annual financial statements of Company B. This is so, because all remuneration paid to or receivable while being a prescribed officer of the company (in this case Company B) f**or services as a director of any other company within the same group of companies** (Company A) must be disclosed. (See 30(5)(b)(i) above).

In order to ensure compliance, a company will have to make a list of all its directors and prescribed officers (the individuals for which disclosure will be made) and then determine the structure of the group of which the company forms a part. In this regard the definition of a group should be considered (the Act refers to any other company within the same group – this means disclosure will have to account for all other companies in the group, and not only the subsidiaries of the company in question). For purposes of this section, the company will have to take into account all companies in the group – thus upward, downward and sideways. Disclosure is required of all remuneration paid to or receivable by the directors and prescribed officers of the company **for services as a director or prescribed officer of any other company within the same group of companies**.

Note: The Act requires all remuneration **paid to or receivable by** directors and prescribed officers to be disclosed. It does not only account for remuneration paid by the company, or another company in the group. Rather, it focuses on the amounts a director or prescribed officer earns for services as a director or prescribed officer (to the company or any other company within the group), or for the carrying on the affairs of the company (or any other company within the group).

Queries:

Dr Johan Erasmus	
Director	
Tel:	+27 11 806 6292
Email:	jerasmus@deloitte.co.za

Designed and produced by Creative Services at Deloitte, Johannesburg. (807473/mar)