



Australasian
Compliance
Institute

Executive Remuneration Inquiry
Productivity Commission
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Via email: exec_remuneration@pc.gov.au

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Regulation of Director & Executive Remuneration in Australia

The Australasian Compliance Institute (ACI) would like to take the opportunity to thank the Australian Productivity Commission for providing an opportunity for ACI to make a submission and comment upon its inquiry into the regulation of Director & Executive Remuneration in Australia.

ACI is the peak industry body for the practice of compliance in Australasia. Our members are compliance, risk and governance professionals actively engaged in the private, professional services and Government sectors within Australia, New Zealand, Singapore, Thailand and Hong Kong.

Our submission will concentrate upon the setting of performance payments for directors and executives (TOR 1 and TOR 4) and adoption of existing standards to improve regulatory effectiveness (TOR 2).

A growing area of community concern has been the perceived disconnect between the financial goals of individuals that run organisations, shareholders and customers. Of particular note is the breakdown in the relationship between bonus payments despite corporate failures that take the form of either financial loss, fraud, regulatory breach or excessive risk taking outside normal business parameters. ACI believes that the balance between performance payments and general business and community expectations can be returned through the introduction of new Key Performance Indicators (KPIs) that focus upon the governance of the organisation (with a emphasis upon compliance and risk management).

A number of organisations have already taken this approach, where bonus payments for senior staff and CEOs are not paid if the organisation does not also operate within its pre-established compliance and risk parameters. It is important to note that the inclusion of such KPIs cannot focus upon minimising breaches as the determining factor as this will create a culture where not all breaches are reported or recorded so that the internal controls are not breached and therefore bonus payments are not jeopardised.

Principal Members



The focus of compliance and risk KPIs (especially at the most senior end of the organisation) needs to be around the establishment of the framework, the allocation of resources to ensure it is effective, the existence of clear reporting lines from those responsible for the operation of the scheme to decision makers, the monitoring of the system and the existence of continual improvement. If all of these components are present and in effective operation, then the Directors and CEO would be eligible to receive their bonus payments. Further down the management chain, the KPIs should then focus on the granular components required to make the framework operational and ensure that the organisation is creating a 'culture of compliance'.

For reference purposes, a copy of some compliance KPIs used by some of ACI's member organisations has been attached for information purposes.

Closely associated with our discussions above is use of Australian / New Zealand Standard AS/NZ3806 which has been created to allow organisations to benchmark their compliance frameworks against. The standard comprises of 12 Principals grouped into four broad themes. These are as follows:

- Commitment
- Implementation
- Monitoring & Measuring
- Continuous Improvement

Under the theme of 'Commitment' there are five principals which relate specifically to the 'tone at the top' established by the organisation's leadership and key decision makers. It is these principles that should be built into the performance measures of executives. Namely:

- Commitment by governing body and top management to compliance
- Alignment of compliance policies with the business strategies and objectives
- Appropriate resources are allocated to develop, maintain and improve the compliance program
- The objectives and strategy of the compliance program have been agreed upon
- The compliance requirements have been identified and assessed.

In fact parallels can be drawn with the Australian / New Zealand Risk Standard AS/NS 4360 that has similar requirements established;

- Ensure the risk program has the support of senior management
- Risk management should be embedded into the policy development, business and strategic planning and change management processes
- Ensure adequate resources are allocated
- The risk management plan should define how risk management is to be conducted throughout the organisation
- Identify risks, analyse risks, evaluate risks, treat risks

The adoption of these two standards by organisations not only allows them to create a sound risk management and compliance framework, it also sets the basic performance criteria the senior management, management and employees can have their performance judged by. Together with the inclusion of KPIs drawn from these standards for all employees, then the organisation can create a culture of compliance or good governance that can be measured by undertaking climate surveys of the staff and senior management. It is here were the performance of senior executives can be judged and bonuses awarded or withheld accordingly.

It is on this basis that ACI would like to see the mandatory adoption of what until now have been two voluntary standards.

Recommendations

ACI would like make the following recommendations to the Productivity Commission with respect to ASX 200 companies as well as all organisations that hold an Australian Financial Services Licence.

- That risk and compliance KPIs become mandatory for all Directors, CEOs and senior management that report directly into the CEO.
- Failure to meet compliance and risk KPIs would result in the non payment of performance bonuses.
- That AS/NZ 3806 and AS/NZ 4360 be mandated as a benchmarking tool for the aforementioned organisations to ensure that their compliance and risk programmes meet industry best practice¹ and as a means to provide additional support to the existing regulatory framework..

Once again ACI would like to thank the Productivity Commission for providing an opportunity for ACI to make a submission its inquiry into the regulation of Director & Executive Remuneration in Australia. Should you require any additional information or seek clarification on the comments that appear in this submission please do not hesitate to contact ACI on +612 9290 1788.

Yours sincerely,

Martin Tolar
Chief Executive Officer

¹ It should be noted that AS/NZ 4360 is in the final stages of gaining ISO status and ACI has commence work to have AS/NZ 3860 adopted as an ISO standard.

Examples of Compliance KPIs that can be incorporated into Executive's Bonus Schemes

- Compliance and Risk framework reviewed and improvements made
- Modification to compliance and risk framework communicated to all staff and training undertaken where required
- Compliance and risk framework aligned with overall business strategy
- Financial and human resources allocated to compliance and risk function
- Compliance Breaches:
 - Numbers of significant breaches reported and how they compared against past performance
 - Nature of compliance and risk breaches
 - time taken to report each breach (from initial identification)
 - Time taken to resolve, including any customer compensation
 - \$ cost of breaches to organisation
 - Number of disciplinary actions taken relating to compliance breaches
- Complaints handling:
 - Numbers of complaints reported compared against past performance
 - Time taken to resolve, including any customer compensation
 - \$ cost to organisation
 - Where referred externally, numbers of complaints resolved in favour of the organisation.
- Number of staff who have not undertaken mandatory compliance training
- Climate survey that also measures compliance culture within the organisation and compared to previous years.
- Time taken to complete actions arising from recommendations coming from Internal Audit reviews

Sample KPIs Compliance (Department Managers)						
<i>Objective</i>	<i>KPI</i>	<i>Review Period</i>	<i>Lead Indicator</i>	<i>Lag Indicator</i>	<i>Comment</i>	
To ensure all department staff fulfil compliance obligations	<ul style="list-style-type: none"> All employees are aware of compliance obligations and the nature of legal compliance 	As Required	All relevant employees are trained in legal compliance on induction	<ul style="list-style-type: none"> Records indicate compliance training has been carried out Checks with new employees indicates they were trained before being authorised to act 	Records alone are not likely to show whether anyone operated outside their authorised capacity – a simple check closes the gap and imposes discipline.	
To ensure that at all times there is a completed and up to date Compliance Register	<ul style="list-style-type: none"> Ensure a formal Compliance Register is maintained Compliance risks are reviewed twice per year New compliance risks are identified and action taken to eliminate or reduce is recorded 	Continuous six monthly six monthly	All employees are aware of duty to report compliance breaches	Records show that this is the case	Continuing awareness is the issue. The fact that they have been trained does not ensure this.	
Ensure proper training in compliance issues	<ul style="list-style-type: none"> Any training required on new risks is implemented promptly All relevant employees receive refresher training There are written results of training, including each participant's results (pass mark 80%) 	six monthly Annually As required	All relevant employees receive refresher training There are written results of training, including each participant's results (pass mark 80%)	Records show that this is the case. Check employees awareness of lessons from training. Check that Failures are not carrying out tasks relevant to an authorised person.	The lead indicator does not prevent breaches from occurring. Even if it did a check is still needed that this is observed	

<p>To ensure all staff to: Fulfill their risk management obligations; Are appropriately trained to do so; and Verifiable records are kept.</p>	<p>Ensure all employees are trained in, and aware of, risk management procedures, obligations and the Risk Management Framework Arrange training for new risks identified Ensure all relevant employees receive periodic refresher training Maintain documented records of training Ensure new employees are appropriately trained in risk management procedures before being authorised to act.</p>	<p>As Required As Required As required but not less than once each 36 months Continuous As required</p>	<p>A verifiable audit trail which indicates:</p> <ul style="list-style-type: none"> • Risk management training has been carried out • Training provided where new risks identified • Refresher training conducted at least once each 36 months • Training records kept and maintained • New employees were given appropriate training before being authorised to act 	<p>Records alone are not likely to show whether anyone operated outside their authorised capacity – a simple check closes the gap and imposes discipline.</p>
<p>To ensure that at all times there is an up to date Corporate Risk Register and that the Board and management receive useful and timely reports on the corporation's risk exposure.</p>	<p>New risks are identified and action taken to transfer, eliminate or reduce the risk Ensure all risks are identified and forwarded to the Manager Risk & Internal Audit for inclusion in the Corporate Risk Register Report on the status of risks and mitigating action as required</p>	<p>Continuous Monthly for major risks Continuous</p>	<p>A verifiable audit trail which indicates:</p> <ul style="list-style-type: none"> • New risks identified and forwarded to the Manager Risk & Internal Audit. • Risk status reports completed by due date. 	<p>Continuing awareness is the issue. The corporation needs to know the totality of its risk exposure.</p>