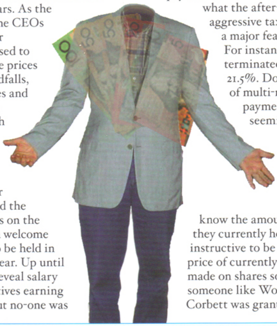
When Knowledge is Power

Stephen Mayne argues the case for more transparency in the world of executive pay and perks

Booming markets often lead to excesses and the executive pay packets at Australia's major companies are certainly pushing the boundaries both in their quantum and the level of disclosure to shareholders. One example: when a CEO is issued with yet another round of options it would be useful to know just how much they have made out of previous issues of shares. Sadly, this sort of information is not mandated by the myriad of regulators spanning ASIC, the ASX and the accounting standards.

Even the information disclosed to shareholders often falls well short of the mark. A recent study by Proxy Australia looked at 24 ASX 100 companies that had been continuously disclosing the "fair value" of options since 1999, and whose CEO had exercised options over the past three years. As the table demonstrates, many of the CEOs enjoyed windfall gains on their options that were never disclosed to shareholders. Sure, rising share prices have contributed to these windfalls, but it also looks like companies and their advisers have been using valuation methodologies which systematically underestimate options values.



Australia continues to move down the path towards greater disclosure of executive pay, and the British-style non-binding votes on the remuneration reports will be a welcome addition at the 1000 AGMs to be held in October and November this year. Up until 1999, companies only had to reveal salary bands for directors and executives earning more than $100,000 a year, but no-one was named so it was a public guessing game.

Labor and the minor parties got together and introduced some legislative amendments that required companies to reveal exactly what each director was paid and a detailed breakdown of the top five executives. This was a substantial step forward, although there's some force to the argument that all this disclosure actually contributed to a salary explosion as senior executives were able to point to what rivals were being paid while haggling for a pay rise.

The other substantial change was in 2000 when the capital gains tax rate was halved for investments held for longer than 12 months. Like more than a million workers, CEOs were sick of paying the punitive top rate of 48.5c in the dollar, so salary packaging increasingly saw options and share issues included which could then be sold after 12 months at an effective tax rate of just 23.5%. This is where the unreported windfall gains outlined in the table come into play.

So what would constitute a perfect world for executive pay disclosure? Well, it would be great to know what the after-tax payments are, as aggressive tax planning is becoming a major feature of CEO packages. For instance, executives who get terminated only pay tax at the rate of 21.5%. Does this explain the presence of multi-million dollar termination payments for executives who seemingly retired happily, such as BHP's Paul Anderson and former Foster's CEO Ted Kunkel?

When debating whether to give a CEO more options you only know the amount of shares and options they currently hold. It would be far more instructive to be told the average purchase price of currently held shares and any profits made on shares sold in the past. And when someone like Woolworths CEO Roger Corbett was granted an additional two million options last year, it would have been nice to know he was already more than $30 million in front on his existing share plays. Sadly, the dreadfully inaccurate forecasts of options profits and complicated tax planning shows that we still have a long way to go to get an accurate picture on who is taking home what at the top end of town.

Five Inaccurate Option Valuations

David Murray, CBA CEO: 2001 options valued at $920,000, windfall gain when exercised $11.87m

David Morgan, Westpac CEO: 1999 options valued at $1.61m, windfall gain when exercised $11.95m

Kirby Adams, Bluescope Steel CEO: 2002 options valued at $0.5m, windfall gain when exercised $6.1m

Michael Hawker, IAG CEO: 2002 options valued at $0.5m, windfall gain when exercised $6.1m

Colin Goldschmidt, Sonic Healthcare CEO: 2000 options valued at $2.35m, windfall gain when exercised $7.66m

Source: Proxy Australia

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