

**Review**  
*of*  
**Remuneration**  
*for the office of*  
**Secretary**

**Australian Government**  
**Departments of State**

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**Prepared for**

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**The Commonwealth Remuneration Tribunal**

**Prepared by**

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# 1. Remuneration of Secretaries

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## 1.1 Introduction

This Report is one of two companion reports prepared by John Egan of Egan Associates for the Remuneration Tribunal<sup>1</sup>. While each document is intended as a separate communication, their functions are complementary.

## 1.2 Acknowledgements

I would also specifically wish to acknowledge the assistance of Kirsten Ross in the preparation of the analysis of various data, as well as Beverley Elith who typed numerous drafts of the manuscript over an extended period of time.

I would also wish to acknowledge the considerable guidance and cooperation which I received from John Conde, the President of the Tribunal, over an extended period of time, and Derren Gillespie, the Secretary to the Tribunal.

## 1.3 Executive Summary

Having determined the relative work value of the positions of Secretary of Australian Government Departments and published a report addressing those issues, the current report deals with pay and conditions of Department Secretaries.

In order to form a view of competitive reward, across Government nationally and the private sector to the extent that it has a relevance having regard to positions of comparable work value and complexity, I compiled information on total fixed remuneration of Chief Executives and the second highest paid executives in companies in the ASX 200 and additionally obtained information on remuneration levels of senior executives in corporatised Government organisations, Vice-Chancellors of universities, partners of leading professional firms where there is an active shared engagement in the work of Government and the programs under the stewardship of Department Secretaries. I have also had regard to the relative scale of expenditure under the direction of Secretaries, including appropriations for agencies for which the Minister and/or the Cabinet hold the Secretary accountable. I formed the view that there was a degree of alignment between CEOs in a subsection of the ASX 200 and 2ICs or the second highest paid executive in the top corporations.

Equally, in addressing this data, due to the different nature of the role of a Secretary compared to that of an executive in the private sector, I have ignored performance aligned reward in the latter as a base of comparison and retained a focus in relation to positioning the TFR of Secretaries in the second quartile of the private sector market. In undertaking this research I observed, as have others in the past, in reviewing Senior Executive Service positions in the public sector that at the level of Secretary, among many comparators current remuneration arrangements are set in the first quartile of the executive market.

In reviewing the history of adjustments of Secretaries' pay since 1999, I note that the most significant change to their reward came about in 2008 on the recommendation of the Remuneration Tribunal to incorporate the indicative incentive then paid to Secretaries into their fixed remuneration. This led to a market or economic adjustment plus an additional 14 per cent.

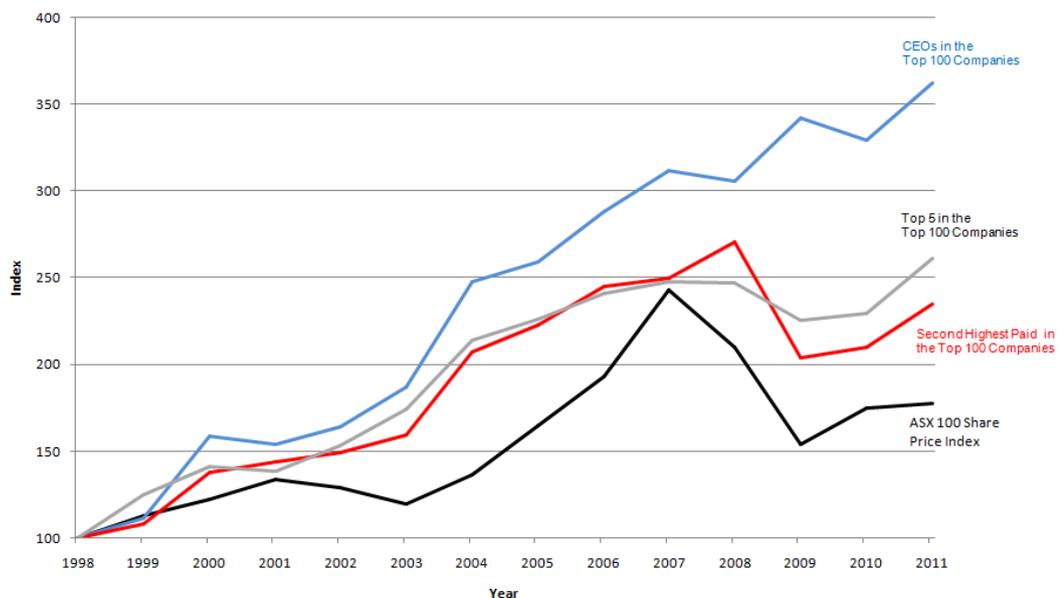
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<sup>1</sup> Review of Work Value for the Office of Secretary, August 2009, by John Egan.

Other than that amendment the primary adjustment to Secretaries' pay over the last twelve or more years has been an economic adjustment and not one reflecting growth in the scale of Department operations and portfolio agencies under the stewardship of Secretaries or the change in the Australian Government's budget dimensions, revenue collections or the nation's GDP.

My research reveals that since the March 1999 determination of a Secretary's remuneration through to August 2011, Secretaries' total fixed remuneration has increased by marginally less than 100 per cent, reflecting a doubling of their fixed pay. Their private sector counterparts in the top 100 companies have over that period benefited from a pay adjustment closely approximating a 360 per cent uplift. The gap in 1999 was reflected by an ASX 100 TFR of around \$500,000 compared to an indicative Secretary's fixed remuneration of around \$270,000, representing a gap of around \$230,000. Today the gap is closer to \$1,250,000. It is this gap which represents a primary disconnect with the reward of the nation's 'executive class' when compared to the most senior executives in the Australian Government upon whom Ministers and the Cabinet rely.

**% Movement in Median Total Annual Remuneration of the Top 100 Companies**  
 Chief Executive Officer, Second and Top 5 Highest Paid Executives  
 30 June 1998 - 30 June 2011



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 Companies are ranked as at 30 June of each year (and excludes property trusts, funds, overseas entities and subsidiaries).  
 From 1998 to 2003, Executive Remuneration Bands were used.  
 From 2004, Executives' Actual Total Annual Remuneration were used.  
 ASX 100 Price Index based on a value of 100 at 30 June 1998. 22 trading day smoothing applied. Source: Thomson Reuters Datastream

My research also revealed that the relationship between Secretaries and their direct reports was much closer in terms of pay relativity than that which applies in the private sector and that as a result of an extended period of modest adjustments the reasonableness of reward levels of Secretaries is now out of step with both Principal Executive Officers in portfolio agencies at both State and Federal level and executives in corporatised entities, where in a number of respects executive accountabilities, while different, are less substantive.

Having regard to the fact that for a variety of reasons recommendations which were initially prepared in early 2009 have been deferred, I developed a proposal which would endeavour to bring Secretaries' total fixed remuneration levels in close approximation to a market TFR 25<sup>th</sup> percentile by the beginning of the 2013 calendar year. In this context a proposal has

been established to facilitate an immediate adjustment to a Secretary's TFR, a further adjustment in July 2012 and a final adjustment before the normalised review of Secretaries' pay in January 2013.

Comment has also been made on aspects of the contractual conditions of Secretaries, with specific recommendations in relation to the unequal participation of Secretaries in the Australian Government's retirement plans and, in my judgement, the inadequate provisions for termination, which can often arise for convenience as distinct from non-performance.

A reward structure has also been developed where there is a conjunction with the maximum pay for a position classified in Level 2 and the minimum rate for a Level 1 Secretary. The classifications of positions follow detailed research in 2009, that report having been published by the Tribunal in March 2010.

For both classification levels of the position of Secretary a range is proposed with a reference rate which represents the minimum rate payable to a Secretary, a higher rate at a premium of 7.5 per cent for a Secretary being appointed to a second term or where on the recommendation of the Secretary of the Department of the Prime Minister and Cabinet and a committee consisting of the President of the Remuneration Tribunal and the Public Service Commissioner a Secretary's pay is seen to be misaligned having regard to their length of service and the distinction with which they have served the Government over a period of time. Proposals are also made in relation to transitioning Secretaries from a Level 2 to a Level 1 position or the reverse, which may arise as a result of substantial changes to the structure and portfolio allocation of Departments. Illustrative of the latter circumstance is the significant expansion of the accountability of the Secretary of the Department of Human Services following the absorption of both Medicare and Centrelink within the Department since my initial research in 2008.

The initial recommended reference rate for a Level 1 Secretary position is \$672,750 and for a Level 2 position \$585,000. The reference rate for these positions in 2013 is \$747,500 and \$650,000 respectively.

My recommendation varies in relativity terms from the long established relationship between Level 1 and Level 2 Secretary positions which have embraced a single rate of pay strategy, with the relationship between a Level 1 and a Level 2 position being set at 93 per cent.

Given that nine positions (rather than three) are now classified as at Level 1 having regard to the factors set out in the Work Value Report, I have formed the view that the gap in work value between the two levels is more substantial than was previously the case, although acknowledge that Secretaries remain engaged in *'Whole of Government'* initiatives and have proposed that the gap between the reference rates of Level 1 and Level 2 be set at 85 per cent.

I have also proposed that for the positions of Secretary of the Department of Prime Minister and Cabinet and the Secretary of Treasury that the Tribunal have flexibility to determine the total fixed remuneration of the incumbents of those two key positions within a range set at a maximum of 20 per cent above the reference rate for a Level 1 Secretary's position.

### **Reward and Employment of Secretaries**

In addressing the context of employment of a Secretary it was important to understand the history of pay adjustments over recent years at the level of Secretary as well as that of the other most senior staff in the Government's executive service, including Deputy Secretaries and more recently Associate Secretaries, their terms and conditions and the relativities

established between those roles and other senior roles in a Department and that of the Secretary.

What did arise from those observations and required special consideration was the impact of progressive adjustments to employment conditions, including pay, at varying levels in the Australian Public Service (APS). These adjustments narrowed the gap between the reward of Secretaries and their direct reports and modified the positioning of Secretaries having regard to fixed remuneration in the broader leadership market of Australia. The most recent adjustments in August 2011 continued to show a Secretary's remuneration positioning in the lowest quartile. At the time of preparing this report in November 2011 the relative position of Secretary in the Australian marketplace has continued to deteriorate, albeit that the rate of growth in fixed remuneration of senior executives in the private sector has been modified, initially as a result of the global financial crisis and more recently volatile securities markets, particularly in Europe and North America, and a slowing in the rate of growth in the leading Asian economies.

The above comparative observation is based on a Secretary's total reward, that is their total fixed remuneration which, following the June 2008 determination and subsequent determinations, incorporates a bonus component (14 per cent), whereas private sector executive remuneration, particularly in listed companies, consists of fixed remuneration and bonus payments, both in cash and in the form of equity, the aggregate of each of those elements constituting a senior executive's total reward.

Arising from the different descriptors of remuneration in both the private and public sectors and the change in the foundation of Secretaries' remuneration with effect from July 2008, for the purpose of this report I will refer to a Secretary's total remuneration as presently structured as 'Total Fixed Remuneration' in order not to be confused with the universal nomenclature of 'Total Remuneration' which includes an element of at risk performance pay. In this context, in other areas of the Tribunal's jurisdiction I would propose that they nominate the elements of remuneration exclusive of at risk performance pay moving forward as 'Total Fixed Remuneration' (TFR) representing the total value of salary together with superannuation and non-cash benefits, with 'Total Remuneration' (TR) incorporating TFR and at risk performance pay.

In the broader market many companies benchmark their Chief Executive Officer (CEO) and their most senior executives having regard to an agreed competitive positioning and establish a range within which the executive's fixed remuneration is determined, enabling them to accommodate factors which might include the recency of the executive's *appointment to the position, their performance and effectiveness, their potential and promotability* or any specific market influences which a company determines to be critical in assigning a specific pay level.

I noted during the conduct of the review, particularly at the time of formulating the approach to the primary questions (that of work value and remuneration), that in establishing a clear nomenclature and framework for the study without conflicting with other work of the Tribunal or the Public Service Commissioner it was relevant to establish some common language and common terms. Accordingly, and noting that there are structures for Principal Executive Officers (PEOs) and for members of the Senior Executive Service (SES), I determined that while there were differences in the accountability of Secretaries they represented a single cohort in Government leadership. Traditionally the position of Secretary has been rewarded across a number of pay levels varying from four to two (the present arrangement). Attached to each classification level there has traditionally been a level of fixed remuneration, together with an opportunity for a performance related bonus payment, this practice having been discontinued in June 2008.

The recommendations which are set out below are based on the construct of a pay band similar to that adopted by the Tribunal in respect of PEOs.

The question which the Tribunal needs to determine in this context is the appropriateness of pay bands versus the traditional practice of a single payment by classification level and secondly, whether there should be a separation in pay between classification levels, as there is at present, ie should pay bands be discrete or overlapping?

At the time of finalising this report both the Tribunal and the Australian Government have the benefit of enquiries into executive remuneration in the private sector, one conducted by Australian Prudential Regulation Authority (APRA) with its primary focus on the financial services sector; in another the Government has asked the Productivity Commission (PC) to examine the remuneration framework adopted for the payment of directors and executives. The latter enquiry was a broad ranging examination which considered the existing regulatory arrangements that apply to director and executive remuneration for companies that are disclosing entities under the Corporations Act 2001, including shareholder voting, as well as disclosure and reporting practices. The Productivity Commission also considered international research and responses to the problems of executive risk taking and corporate greed which were particularly highlighted following the global financial crisis. The latter review represented the most comprehensive single study of executive remuneration undertaken in Australia and led to a series of recommendations, some of which have sponsored proposed changes to legislation which will impact directly on the role of Boards and independent directors. I note that the Tribunal made a submission to the Productivity Commission.

What I did observe in working with the President and members of the Remuneration Tribunal is that it has, in my judgement, one of the most onerous roles in the nation in regard to remuneration assessment when compared to Remuneration Committees of Australia's largest corporations. In addition to addressing the positions of Secretary across twenty Government Departments (my earlier research covered nineteen Departments – the new structure establishing from the original Department of Infrastructure, Transport, Regional Development and Local Government the Departments of Infrastructure and Transport and Regional Australia, Regional Development and Local Government), the Tribunal also addresses the reward arrangements of a substantial proportion of the Chief Executives of the 150 plus portfolio agencies within the Government, members of Parliament, members of Advisory Boards and formal Boards of a number of statutory bodies, the judiciary and other specialist roles within Government. This represented a range of enterprises and sectors which was breathtaking. It was equally evident in preparing this report that the Tribunal had a responsibility not only to research material provided to the Tribunal by the Secretariat but also to independently inform itself on aspects of its wider responsibility and to equip itself with information and opinions on a significant diversity of issues being brought to its attention and requiring deliberation.

Since commencing my work in reviewing both the work value and remuneration of the position of Secretary in 2008, there have been two adjustments to the total fixed remuneration of a Secretary broadly in accordance with general movements in executive pay in the Australian Public Service and further, there has been a legislative change in August 2011 which amended the Remuneration Tribunal Act 1973 (Act No. 215 of 1973 as amended), giving the Tribunal power to determine the remuneration of Secretaries – Part 11 Division 4.

## 1.4 Overview

It is acknowledged that the Tribunal, in meeting its obligations under Act No. 215 of 1973 as amended, is required to determine all elements of a Secretary's employment conditions on which it has previously provided advice to the Government over several decades.

It is not the purpose of this report to comment on specific determinations of the Tribunal outside the context of the principal employment benefits and termination provisions available to a Secretary of a Commonwealth Department. In that context this report will not comment on matters that are outside the provision of total remuneration and certain contractual matters primarily in relation to loss of office.

I have not undertaken separate research, nor am I providing advice, in relation to either the employer's or the Secretary's contribution to superannuation other than to the extent it influences the current net income proportion of the total fixed remuneration of a Secretary. I do report on certain employee benefits which form part of a senior executive's total remuneration in other Australian public services, particularly in relation to the provision of vehicles and parking. I make no comment on business support, including communications, information technology and other office facilities made available to Secretaries to assist them in fulfilling their obligations.

I make no comment on Secretaries' entitlement to domestic or international airline memberships, leave in relation to recreational and personal leave, miscellaneous leave or statutory leave, removal or relocation assistance, disturbance allowances or related allowances or provisions associated with the relocation of a Secretary from a city other than Canberra, nor reunion travel, dependants' education allowances, leave for training and development or any support in that regard for which the Tribunal and/or the Public Service Commissioner have recommended policies appropriate for the position of Secretary.

In dealing with the issue of a total remuneration package and in establishing comparisons with other employers in both the Government and private sector, comment is made on the inclusions in total fixed remuneration as well as at risk, variable performance reward which may be cash settled or settled by way of participation in an equity program.

It is acknowledged that at the time of preparing this report debate continues in relation to executive remuneration generally and in particular comment on Government legislative and regulatory initiatives which impact on both the conduct and scrutiny of significant listed public companies. It is my assessment that while debate and discussion has received elevated attention in the press, in Parliamentary debate and other forums, it has limited impact on the current research or the recommendations arising from that research.

The reward arrangements recommended do not incorporate any performance or incentive payments related to specific financial or other transactions under the stewardship of a Secretary, nor do the recommendations embrace private sector incentive constructs. While there is limited discussion on performance pay as it applies in other public sector organisations and in the SES, the report does not include a specific recommendation for the near-term return of performance pay for Secretaries employed by the Commonwealth of Australia. It is acknowledged that performance pay does exist in a number of Commonwealth Government portfolio agencies and does constitute an element of a senior executive's total reward, including that of the Chief Executive Officer, in those agencies.

The report acknowledges the recommendation of the Tribunal of June 2008 that the performance bonus component previously available to Secretaries be incorporated into the

annual remuneration of a Secretary. In the context of the employment of Secretaries, it is my view that the recommendation of the Tribunal represented an appropriate decision and retains currency in the prevailing environment.

As noted above, while conditions of employment of Secretaries of Commonwealth Departments have previously been recommended by the Tribunal, I note under the August 2011 amendments to the legislation the Tribunal now have the power to determine the fixed remuneration and conditions of employment of a Secretary, those determinations being made within the framework of other Government policy and programs administered by the Australian Public Service Commission.

I note in reports (either provided to the Department of Education, Employment and Workplace Relations or the Australian Public Service Commission prepared by Mercer in 2007, 2008, 2010 and 2011<sup>2</sup>) that a proportion of Australian Public Service organisations draw on the private sector as a source of comparison though for positions in SES 2 and 3 (the most senior positions reporting to a Secretary) rates of pay across the APS are the dominant source of their comparison and review consideration. Mercer's research across the Government sector reveals reasonable dispersion between the remuneration of less well paid executives and the most highly paid executives in each broad SES classification.

## 1.5 Background

The Australian public sector does embrace differential reward arrangements for the most senior officers in Government, particularly in portfolio agencies, where a number have chosen to position their CEO and senior executive reward more broadly in alignment with the private sector in fixed remuneration (though positioned well below the median having regard to at risk performance aligned reward), not the APS internal rate of reward having regard to work value.

### 1.5.1 Work Value

In the companion report to this report on the remuneration of Secretaries, comprehensive documentation was prepared setting out a perspective on the role and work value of the position of Secretary.<sup>3</sup> The following paragraphs represent extracts from that report which provide a setting in relation to the nature and breadth of the role of a Secretary and the broad foundation associated with the placement of the role of Secretary, including the position's engagement in 'Whole of Government' initiatives.

*"In developing a work value structure for the office of Secretary I have had sole regard to the position's accountabilities and not in parallel developed a statement of the necessary experience that one might expect to find in a Secretary at each classification level, nor the specific competencies that one might expect to observe in a particular portfolio. These attributes could in part be deduced from the Statement of Accountability of the individual positions of Secretary which are appended to this report. The classification structure developed has of necessity embraced some acknowledgement of the process of appointment of Secretaries and the Parliamentary setting of the stewardship of Australia Inc. In considering the attributes of the role of Secretary I was equally mindful that only three appointments to the position have been made in the past fifteen or more years from outside the Government sector.*

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<sup>2</sup> 2006, 2007, 2009 and 2010 APS SES Remuneration Survey (prepared by Mercer Human Resource Consulting).

<sup>3</sup> Review of Work Value for the Office of Secretary, published March 2010 though written in 2008.

*In that context, in considering work value I have seen the majority of positions of Secretary as business group executives with distinct and different operations, each meeting their allocated requirements in the support of Australia Inc under the leadership of the Prime Minister and direction of the Cabinet, coordinated by the Department of the Prime Minister and Cabinet, with significant though different input to the Office of the Prime Minister by the Secretaries of the Departments of the Treasury and of Finance and Deregulation.*

*In a 'Whole of Government' context and reflecting variable demand, subject to events of the day, Secretaries either collaboratively or in a more portfolio-focused mode will be required to marshal significant resources to contend with matters of a national scale involving policy and operational complexity, community and political sensitivity and economic impact. Recent examples of these issues would include:*

- *the Government's domestic and international response to the global financial crisis;*
- *the Government's support package to the banks and financial sector generally;*
- *the Government's support package for the domestic motor vehicle industry;*
- *the Government's engagement and response to the Victorian bushfires and Queensland and New South Wales floods;*
- *the Government's engagement in establishing an infrastructure framework for a globally competitive digital economy;*
- *the Government's proposed 'Carbon Pollution Reduction Scheme'.*

*The last mentioned project represents a significant program which has entailed the compilation of multi-sourced external advice at the highest levels, extensive nationwide consultations, including the provision of opportunities for submissions from interested parties (major corporations and representative bodies), at the end of which a Government policy was formulated and circulated and the legislation introduced into Parliament. These processes, which will impact at varying times on the engagement of Secretaries in the business of Government, are unique to Government.*

*Other factors in which Secretaries, Ministers and advisors to the Government will need to engage and respond include the collapse of businesses impacting directly on many communities (ABC Learning), the Government's recent \$42 billion package in response to challenging economic times at both corporate and individual level and more recently, its \$40 billion plus proposal involving substantial Government funds in establishing a globally competitive digital economy."*

In a speech in November 2011 reflecting on the 'State of the Service', Dr Ian Watt, Secretary of the Department of the Prime Minister and Cabinet, revealed that over the next decade the Government would be required to:

- help manage major demographic change,
- better position Australia in an Asian century,
- help guide the economy through fundamental structural changes,
- achieve more with fewer resources and achieve faster while minimising risks,
- meet the rising demand of citizens, giving them more input in designing policies and services,
- improve delivery and implementation, and
- adapt to ever faster technological change in information flows.

*“These matters of national and/or regional consequence take on a character and a scale not normally reflective of a significant enterprise’s involvements in its national or international workforce adjustments, refinancing debt or asset sales programs. The demands on a nation are fluid and variation in the nature of those demands and scale highlights the challenges for Departments of State and indeed their Secretaries. These are generally not demands observed in the private sector, albeit that the private sector is a key constituent in contributing to the economic wellbeing of the nation and its gross domestic product*

*I note in the context of ‘Whole of Government’ that both revenues and expenditures of the Commonwealth Government exceed \$250 billion and that the national gross domestic product which the Government continually endeavours to enhance exceeds \$1.25 trillion.*

*Another area of complexity in adjudicating on the classification of the position of Secretary is the nature of the engagement of the Secretary in the wider area of the Minister’s involvements in the management of his or her portfolio agencies, which include direct engagement in some instances with the agency’s Chief Executive Officer, in others with the Chairman of the Board or both.*

*I also observed that a number of Secretaries serve on the boards of the agencies, statutory corporations or other bodies within the province of their Minister’s accountability from enterprises as diverse as the Australian Sports Commission to the Reserve Bank of Australia. I also noted, as I have in the private sector, that a number of Secretaries sit on international bodies relevant to their Minister’s portfolio and/or their expertise, bringing the benefit of those engagements to the Government of the day.*

*While acknowledging in this report some specific differences in the nature of and accountability of a Secretary and that of a CEO of a major public company, both generally and within a ‘Whole of Government’ context, it is my judgement that it remains the closest comparator for the position of Secretary. Due to the varied obligations of executives known as Chief Operating Officers, while broadly generic in character, comparison of the office of Secretary with this position is not appropriate. Comparison with the position of business group head is also not appropriate given the primary accountabilities of the position of Secretary. While the position of Secretary has a number of comparable attributes within the construct of ‘Whole of Government’, it could be argued that similarly within the context of Australia Inc there are many substantial private sector companies providing retail services, exploring and mining the mineral and energy resources of the nation, providing health services, business services, technology and science based services, insurance services, financial services, etc. Each of these entities has a relatively modest constituency of shareholders, some international shareholders, though in no sense a ‘whole of nation’ focused set of obligations.*

*In most respects the government of the day expects Secretaries to manage allocated resources efficiently, either as advisers, resource allocators or service providers without having a profit motive, though ever mindful of stakeholder outcomes. It is evident that Secretaries have fiduciary obligations for dispensing public monies and for the management of public assets. Secretaries deal with significant risk of fraud in relation to both elements. Risk management, particularly in the current challenging economic environment, is real because of Government guarantees in many organisations under the oversight of Secretaries, though often directly reporting to Ministers. Notwithstanding that, the actual fiduciary accountability rests primarily with the Secretary. From the Minister’s and the Government’s perspective Secretaries are also required to advise in relation to political risk and reputational risk.*

*A Secretary's role is to both manage operations and to provide advice to the Government of the day. In the latter context they must remain fearless in relation to the independence of their advice. This is an area where many Secretaries are challenged by such an obligation. It reflects a requirement for a significant capacity to operate in environments of high complexity and changing priorities of Government with the end goal reflecting values at variance with the private sector. Within the Westminster system of Government the value of advice from the position of Secretary is key.*

*The role of a Secretary in this context is primarily to facilitate effective decisions being made by Government. Secretaries are accountable to a Minister who is in a sense a semi Executive Chairman, though not an independent Chairman nor necessarily skilled in the relevant disciplines or seasoned in dealing with the issues of the Department. A Minister's office will also be a key point of interface and often be called upon to handle significant political or reputational issues and be another source of advice to the Minister.*

### **Level 1 Classification**

*This level is the province of the key 'Whole of Government' roles within the Secretary structure, as well as those positions which have accountability for the oversight of Departments of significant scale and reach in relation to the program priorities of Government.*

*At this level the work of the Secretary requires a continual screening of the global environment to identify and favourably influence the Minister or the Executive of Government on any or all developments that might have significance to the Australian Government.....*

*The province of the Secretary at this level is to assess and address the relevance of the bombardment of information about political, economic, social, technological and intellectual events from a global environment requiring a unique response consistent with the Australian Government's future aspirations (all spheres of Government, both Federal and State).*

*The focus of the work is on both domestic and international networking in all areas likely to be significant to the Australian Government in any field of endeavour. The Secretary must accumulate significant data and screen out the less significant.....*

*The primary thrust of the work is creating an internal environment that makes it possible to judge a myriad of policy and investment priorities to enhance the value of the Government's assets and the nation's resources and contribute to its long term success and sustainability. Work at this level calls for worldwide data accumulation and analysis.....*

*Secretaries at this classification level have to cope by means of judgement with a constantly shifting kaleidoscope of events and consequences with far too many variables to readily map. In pursuing their plans Secretaries must sense interconnections across the 'Whole of Government' and the broader environment and continually adjust them in relation to each other with a sensing for all internal and environmental second and third order effects....*

### **Level 2 Classification**

*Secretaries at this management level undertake work requiring several interactive projects, each of which is adjusted in relation to the others. At this level.... Secretaries do not pursue a single path but are required to establish a number of paths and alternatives, all running at the same time and interconnected one with the other.*

*Secretaries at this level of organisational complexity pursue a number of different programs in synchrony with one another, harmonising and resourcing the Government's priorities while meeting schedules and guiding activity into alternate paths where necessary. There is a necessity to make trade-offs between tasks and resources in order to maintain progress along the composite route to achieving a key goal of Government which is likely to involve Government, business and community stakeholders, the latter two with significant self interest.*

*Work at this level calls for parallel processing and trading-off. The usual time frame is two to five years, though certain elements of the role and consequences of policy or program initiatives will extend beyond five years.*

*The policy, budget, resourcing and geographic dimensions of these positions in relation to the oversight of Government programs are below those in Level 1, though encompass major areas of economic significance for Government, as well as service delivery or complex policy formulation where timely and appropriate outcomes are fundamental to the Government's reputation."*

### **1.5.2 Pay Competitiveness**

It would appear, on the basis of discussions with Secretaries and others, that as the level of seniority of appointment in Government increases to a point of achieving an appointment to the position of Deputy Secretary and then Secretary, the competitiveness of reward in comparison to the broader marketplace diminishes, being most proximate to the private sector fixed remuneration market 25<sup>th</sup> percentile rate at the position of Deputy Secretary and Associate Secretary and in the first quartile in relation to base or total fixed remuneration at the level of Secretary (this remains the case even with the incorporation of the indicative 14 per cent incentive which is now incorporated within the total fixed remuneration of a Secretary).

In considering the appropriateness of private sector pay as a benchmark for the position of Secretary, I noted that in advice provided to the Tribunal by the prior Public Service Commissioner, Lynelle Briggs, that very few individuals had been appointed to the position of Secretary over the past fifteen years without having had prior public service backgrounds. I further observed that a number of recent hires to the position of Secretary have been secured from other public sector roles at senior level. Information is not available as to whether this fact was a product of the required expertise in Government policy and advice or almost exclusively influenced by the prevailing pay levels.

The competitive positioning of total reward across Government employment will also vary depending upon whether bonus or incentive payments are made. According to the Mercer research, in the upper reaches of the SES bonus payments indicatively reflect around 30 per cent of payments received by comparable positions in the private sector. This comparison, on the basis of my reading, did not embrace consideration of equity based long term incentive participation by senior executives in publicly listed entities.

A recent enquiry in May 2011 by the Remuneration Tribunal observed that base salaries for senior officers in SES band 3 (generally covering the positions of Deputy Secretary and Associate Secretary) varied from around \$240,000 to \$400,000, clearly reflecting the differential in scale of positions, the provenance of individuals assuming such roles and, in some instances, their potential.

The dynamics in private sector reward which are influenced by industry sector and relative market positioning is not a strategy broadly adopted by Government where there is an endeavour to reflect broad equivalence of accountability across Government Departments

and statutory bodies, though there is some evidence in corporatised or commercial enterprises within Government of a need to embrace a degree of responsiveness to relevant markets in the broader field of employment. In this context a number of Government owned enterprises have been required to meet a broader market in meeting their executive employment and retention objectives, these enterprises, for example, include the Australian Broadcasting Commission, Australia Post, Australian Taxation Office, APRA, ASIC, National Broadband Network Company (NBN Company), the Reserve Bank or Medibank Private (or in the past organisations such as the Commonwealth Bank of Australia, Australian Airlines and Qantas).

In attracting their most senior executives to the office of Secretary, it is my judgement that the Commonwealth Government needs to be mindful of reward levels paid to the most senior executives in Government throughout Australia at State and Federal level, including portfolio agencies and fully corporatised enterprises, as well as executive roles in the broader marketplace where comparable experience and expertise is engaged. The Tribunal will also need to consider the reward opportunity of the direct reports to Secretaries and the CEOs of portfolio agencies, as well as their contractual entitlements.

## 1.6 Current employment arrangements

Prior to the enactment of the Public Service Act 1999 and prior to any recommendations of the Remuneration Tribunal following a change to the Remuneration Tribunal Act 1973 (amended by the Parliament in August 2011), the Remuneration Tribunal was empowered to inquire into and determine the remuneration and allowances paid to Secretaries.

In its final determination in respect of Secretaries (No. 4 of 1999, effective 31 March 1999), the Tribunal determined 'total remuneration' amounts for the first time. This approach, intended to cover all elements of Secretaries' remuneration, incorporating the 'loss of tenure' loading (up to 20 per cent of the salary component where applicable); an amount of 13 per cent of the salary component to account for the cost to the employer of superannuation; the notional value of a vehicle, parking and FBT; and an amount ascribed to the value of the scope for overseas spouse-accompanied travel (which had ceased to be available as an employer-provided benefit).

With the passage of the Public Service Act 1999 (PS Act), responsibility for the determination of the remuneration and other conditions of Secretaries was vested in the Prime Minister. S61(2) of the PS Act provides that, for each determination:

..."the Prime Minister must seek the advice of the Remuneration Tribunal and take that advice into account."

The Prime Minister first determined remuneration for Secretaries on 27 May 2001. At this time, the actual - rather than a common, notional - cost of a Government provided vehicle (inclusive of the value of parking and fringe benefits tax – FBT) was factored into the package.

Further, 'base salary' for Secretaries - which serves to define 'salary for superannuation purposes', and as the basis for calculating compensation for early loss of office - was set at 70 per cent of total remuneration while preserving the then current slightly higher ratios for existing Secretaries while they continued to hold office.

In his determination of 6 October 2001, the Prime Minister set out further guidelines in relation to remuneration packaging. It set entitlements additional to total remuneration including communications, information and other office facilities, reimbursement for the costs

of installation and rental of a telephone line and telephone at his or her residence and for all call charges on that telephone and membership of two domestic airline lounges.

In 2003, it was determined that Secretaries receive compensation for business use of their vehicle, on the basis that, as Secretaries met the full cost of their vehicle, there should be some acknowledgement of its use for business purposes.

In July 2005, as well as the annual increase, Secretaries' total remuneration was increased by 1.97 per cent so as to reflect an increase in the employer superannuation contribution from 13 per cent to 15.4 per cent of base salary in line with the employer cost of the new Public Sector Superannuation accumulation plan (PSSAP). Salary for superannuation purposes was also standardised at 73 per cent of total remuneration. The 2005 determination also increased the highest achievable payment for performance to 20 per cent of total remuneration for 'exemplary performance'; 'outstanding performance' attracted a payment of 15 per cent of total remuneration, with 'superior performance' and the new level of 'satisfactory performance' attracting 10 per cent and 5 per cent of total remuneration, respectively.

In July 2006, the Prime Minister's determination increased the proportion of base salary relative to total remuneration from 73 per cent to 80 per cent. The determination also varied the provisions relating to compensation for loss of office; Secretaries became entitled to three months' notice of a decision not to re-appoint or payment-in-lieu of three months' base salary. The provisions for accommodation support were also varied. A Secretary had been entitled, previously, to weekly 'accommodation support payments' if he or she moved to Canberra and continued to maintain a residence in the home locality. The determination varied these arrangements to provide that a Secretary who moved to Canberra would be entitled to the payment of a fixed amount per annum, payable for as long as he or she remained a Secretary; maintains a residence interstate; and does not buy a property in Canberra.

The Prime Minister's 2007 determination made minor amendments to improve the flexibility of Secretaries' remuneration and to align it, where appropriate, with practice in their respective Departments.

In May 2008, the Prime Minister sought the Tribunal's advice about the abolition of performance pay for Secretaries. The Tribunal advised that the performance cycle for 2007-2008 should be concluded by the payment of a lump sum of 14 per cent of total remuneration (this being the order of the average bonus paid to Secretaries in 2006-2007) and that, for 2008-2009, total remuneration for these offices should be increased by the same percentage. Consequently, on 30 June 2008, in addition to that annual adjustment, the Prime Minister determined total remuneration for Secretaries absorbing the previous performance pay arrangements and adjusting base salary proportionately.

In determinations on the basis of advice of the Remuneration Tribunal in October 2010 and August 2011, adjustments reflected in the table below retained the structure of a Secretary's reward in accord with the determinations of 2008.

In relation to superannuation under the total remuneration arrangements it was noted that salary for superannuation purposes comprises base salary plus any additional amount specifically identified as making up the superannuation salary. The notional employer contribution to superannuation is calculated on this superannuation salary. It is noted that in respect of the CSS and PSSS defined benefit schemes the notional value of employer contribution to superannuation is currently 15.4 per cent; this reflects the actual employer

cost of the PSS accumulation plan (PSSAP). For other schemes the value of employee contribution to superannuation is taken to be the amount actually made or liable to be made.

Prior to amendments to Secretaries' TFR in 2008, in the 2005/2006 Annual Report of the Tribunal in the President's Overview it was acknowledged that Secretaries continued to receive remuneration below that of comparable roles in the private sector, which may be further aggravated by appointments to the position having an indicative tenure in the range of three to five years. The report also acknowledged the increasing significance of relativities within the public sector between SES remuneration arrangements and those of Secretary and other senior officeholders.

This latter observation was confirmed in the President's Overview in the 2010/2011 Annual Report: "The Tribunal's "annual adjustments" continue to be modest. The Tribunal notes again that its generally conservative approach has not been followed by those with responsibility for the remuneration of the most senior employees of the Australian Public Service (APS), the Senior Executive Service (SES). The Tribunal has written previously that, as a consequence of this, the remuneration of federal public offices for which the Tribunal determines remuneration has fallen significantly relative to those senior APS employees, in particular. The time has come to remedy this with respect to offices within the Tribunal's jurisdiction."

## 1.7 Pay Levels

The table below sets out the history of adjustments since March 1999 under the prevailing classification structure, identifying the total emoluments of Secretaries.

### Secretaries' remuneration – background – pre-1999 Review to 2006

#### Pre-1999 Review

	Level 1	Level 2
Salary	156,775	144,973
Loss of tenure loading – 20%	31,355	28,995
Non-cash benefits valued at "approx \$60,000"	60,000	60,000
Total remuneration (TR)	248,130	233,968
Proportion of superannuable components to TR	75.82%	74.36%

#### Review of Secretaries' Remuneration – Jan 1999

##### Intro of TR – Proposal

Retention of tenure rights – reduction in salary component of 20%  
 Employer superannuation contribution – 13% of salary component  
 Value of vehicle and overseas spouse travel included in TR  
 Base salary equals superannuation salary

<b>TR as at 31 March 1999</b>	276,000	258,000
Base salary (BS)	205,000	189,500
Base salary as per cent TR	74.28%	73.45%
TR less base salary (TR-BS)	71,000	68,500
Value of super support "taken to be 13%" of base (VSS)	26,650	24,635
Value of other "non-cash benefits" (TR-BS-VSS)	44,350	43,865

<b>TR as at 31 March 2000</b>	305,000	285,000
Base salary (BS)	222,500	205,500
Base salary as per cent TR	72.95%	72.11%
TR less base salary (TR-BS)	82,500	79,500
Value of super support "taken to be 13%" of base (VSS)	28,925	26,715
Value of other "non-cash benefits" (TR-BS-VSS)	53,575	52,785
<b>TR with effect 24 May 2005</b>	355,730	332,820
Base salary (BS)	249,010	232,980
Base salary as per cent TR	70.00%	70.00%
TR less base salary (TR-BS)	106,720	99,840
Value of super support "taken to be 13%" of base (VSS)	32,371	30,287
Value of other "non-cash benefits" (TR-BS-VSS)	74,349	69,553
<b>TR with effect 1 July 2005</b>	377,630	353,310
Base salary (BS)	275,670	257,920
Base salary as per cent TR	73.00%	73.00%
TR less base salary (TR-BS)	101,960	95,390
Value of super support "taken to be 15.4%" of base (VSS)	42,453	39,720
Value of other "non-cash benefits" (TR-BS-VSS)	59,507	55,670
<b>TR with effect 1 July 2006</b>	394,320*	368,920*
Base salary – 80% of TR (BS)	315,456	295,136
Base salary as per cent TR	80.00%	80.00%
TR less base salary (TR-BS)	78,864	73,784
Value of employer super conts "taken to be 15.4%" of base (VSS)	48,580	45,451
Value of other "non-cash benefits" (TR-BS-VSS)	30,284	28,333
Maximum achievable performance bonus	78,864	73,784
<b>TR with effect 1 June 2007</b>	410,890*	384,420*
Base salary – 80% of TR (BS)	328,710	307,540
Base salary as per cent TR	80.00%	80.00%
TR less base salary (TR-BS)	82,180	76,880
Value of employer super conts "taken to be 15.4%" of base (VSS)	50,621	47,361
Value of other "non-cash benefits" (TR-BS-VSS)	31,559	29,519
Maximum achievable performance bonus	82,178	76,884
<b>TR with effect 1 July 2008</b>	488,560	457,080
Base salary – 80% of TR (BS)	390,940	365,670
Base salary as per cent TR	80.00%	80.00%
TR less base salary (TR-BS)	97,620	91,410
Value of employer super conts "taken to be 15.4%" of base (VSS)	60,205	56,313
Value of other "non-cash benefits" (TR-BS-VSS)	37,415	35,097
<b>TR with effect 13 October 2010</b>	523,860	490,100
Base salary – 80% of TR (BS)	419,090	392,080
Base salary as per cent TR	80.00%	80.00%
TR less base salary (TR-BS)	104,770	98,020
Value of employer super conts "taken to be 15.4%" of base (VSS)	64,540	60,380
Value of other "non-cash benefits" (TR-BS-VSS)	40,230	37,640

<b>TR with effect 30 August 2011</b>	539,580	504,810
Base salary – 80% of TR (BS)	431,664	403,848
Base salary as per cent TR	80.00%	80.00%
TR less base salary (TR-BS)	107,916	100,962
Value of employer super conts “taken to be 15.4%” of base (VSS)	66,476	62,192
Value of other “non-cash benefits” (TR-BS-VSS)	41,440	38,770

\* These figures exclude the potential earnings available to a Secretary by way of a performance bonus.

The 2010 determination reflects the flow-on effect of the Remuneration Tribunal’s 2010 review for officeholders of public office, notably a 4.1 per cent adjustment. This adjustment flowed through to a number of public officeholders, including specified statutory officeholders. The adjustment determined on 30 August 2011 was 3 per cent.

## 1.8 Appointment and termination provisions

The bases of the appointment and termination of a Secretary are set out in sections 56, 58, 59 and 60 of the Public Service Act. Section 56 relates to the creation of the office of Secretary and section 60 the engagement of former Secretaries. Section 58 states that the Prime Minister, on advice, appoints a person to the position of Secretary of a Department for a period of up to five years, as specified in the instrument of appointment.

### 1.8.1 Contracts

In various papers on this subject such as that by Andrew Podger<sup>4</sup>, there is discussion of three or five year contracts. As a matter of clarity it should be noted that all the employment arrangements are contracts whether entered into by exchange of letter or by more formal documents. It should also be remembered that much of the contractual relationships are significantly affected by legislation and the Prime Minister’s power of determination.

There has been some public discussion of the movement from five year contracts to three year ones. In his reply to Andrew Podger’s article, Peter Shergold<sup>5</sup> states that he does not believe that the length of term makes “secretaries more supine”. I would suggest that what is equally as important in considering this question is whether the length of the term influences the effectiveness of the Secretary and the Department.

The insistence on three year contracts presupposes continuing high mobility at the upper levels of the Public Service. This may be designed to prevent the development of entrenched and powerful executive teams as much as promoting mobility and the dissemination of new ideas and approaches.

A common attribute of service agreements over recent years in listed public companies in Australia has been to seek a defined period of commitment from a CEO among the nation’s largest companies of five years. There are some signs that defined contractual arrangements with a defined period of service are followed by a continuing evergreen period of service with defined terms in relation to termination. Recent legislation initiated by the Commonwealth Government at the time of the Productivity Commission’s enquiry limiting termination benefits to twelve months’ salary has had an impact on the generosity of termination provisions, with those provisions often being contained to six months’ salary

<sup>4</sup> What Really Happens: Departmental Secretary Appointments, Contracts and Performance Pay in the Australian Public Service. 2007, The Australian Journal of Public Administration, vol 66, no. 2, pp 131-147

<sup>5</sup> What Happens in the APS: An alternative View, 2007, The Australian Journal of Public Administration, vol 66, no. 3, pp 367-370

among listed public companies outside the top 200 and indeed a number within that group of companies. The changed legislative setting has required focussed management where there remains a shortage of talent and to some extent too little development in career and succession planning. In parallel with these circumstances many Boards have an interest in retaining talented and effective executives for periods beyond five years.

Anecdotal evidence in respect of Australia has revealed that CEO turnover among Australia's top 200 companies has been in the order of 20 per cent annually. CEO tenure since the global financial crisis has been more sharply focused on performance, as has pay aligned to shareholder returns.

I understand that the recommendations from the previous Secretary of the Prime Minister and Cabinet recommended that five year terms be the norm, though the service of Secretaries embrace rotations every five to seven years except in specialist agencies.

### 1.8.2 Termination Provisions

Section 59 indicates that the Prime Minister may by notice in writing terminate an appointment of Secretary at any time, though before terminating the appointment the Prime Minister either receives a report from the Secretary of the Department of the Prime Minister and Cabinet, or in respect of the latter, a report from the Public Service Commissioner.

Of particular concern to a number of Secretaries with whom members of the Tribunal and I met were the termination provisions available to them (see Appendix D – Synopsis of Discussions with Secretaries in Part 1 of Egan Associates report, Review of Work Value for the Office of Secretary published on the Tribunal's website under Tribunal Statements – 29 March 2010). Not all Secretaries were long serving members of the APS, though the majority were. It was noted that at the time they were appointed to the position of Secretary they lost entitlement to standard public service redundancy arrangements and entered into a contractual employment relationship with diminished entitlements on termination.

As noted above, in order to gain a degree of clarity in respect of certain conditions of employment and the history of appointments and payments to Secretaries, members of the Tribunal and myself met with the then Public Service Commissioner (2008) who subsequently provided comprehensive background information in relation to my enquiry, including details on amendments to the Public Service Act and other instruments of Government since Federation. The Act was most recently amended in December 1999, setting out the basic termination entitlements of a Secretary which provide for the following:

- three months' base salary or
- one-third of one month's base salary for each full month of the balance of the term not served, subject to a maximum payment of twelve months' base salary calculated at the date of his or her termination, whichever is the greater.

All the Secretarial appointments are subject to sect 59(1) of the Public Service Act 1999 – "The Prime Minister may, by notice in writing, terminate an appointment of Secretary at any time." The key clause in the contract is the one which provides what happens if a Secretary's term in office is cut short. It is in this area that concern was expressed by some of the Secretaries interviewed. I note that in determinations of the Government in relation to fixed remuneration and conditions of employment, provisions in relation to a Secretary's loss of office in the 2010 and 2011 determinations have not been varied.

At the time of the Productivity Commission's review into executive remuneration, reflecting the sensitivity expressed by certain stakeholders and after the conduct of interviews with

Secretaries, the Government introduced legislation to amend the Corporations Act 2001 to limit termination benefits in the private sector in respect of new appointees or at the time of contract renewal. The effect of the legislation is to limit termination payments to executives in leading public companies to twelve months' base salary.

A matter which I observe gaining increasing relevance in the private sector which may well have application to the Commonwealth Government, should they choose to increase the termination benefit at the time of loss of office, is that they could in consideration of an enhanced benefit impose certain restraints in relation to the future employment of a Secretary where the Secretary may have certain information in relation to Government policy or an opportunity to recruit talented executives from the Government sector which the Government may prefer to limit for a minimum period of six months following separation and in that context be prepared to increase the termination payment.

An alternative to the above, though with similar restraints imposed, would be for any future employment within six months of separation from the Government a Secretary be required to seek approval of the Public Service Commissioner to take on other employment opportunities, be they full-time or part-time in the capacity as adviser or director of a listed or unlisted public company or private company where that company is regulated by an agency of Government or has contracts with Commonwealth Government Departments or Agencies.

An important question is whether there should be any age discrimination in the treatment of remuneration on termination. And should the government look to the retirement entitlements of individual Secretaries when contracting to appoint them to positions? In my judgement, given the current policy climate which leans towards terms of three years, the vulnerability of very senior public servants to changes of government attitudes and requirements should be compensated for by making provision for adequate notice and for remuneration support after termination takes place. I recommend that contracts provide for a requirement for six months notice of termination to be either served in office or to be paid for without such service (at the unfettered discretion of the Minister of that Department) with a further payment equivalent to six months' TFR to be made on actual termination. These six months periods would be sequential not tangential.

Notwithstanding the above, on the basis of more than two decades in dealing with CEO contractual entitlements in the private sector, including the criticality or otherwise of term, it is my observation that the most critical clause in every contract is the one which deals with what happens when a CEO is terminated and/or resigns. This clause has precedence over how much the CEO would be paid.

While there is a trend toward evergreen arrangements, increased legislative provisioning in relation to discrimination on the basis of age and discussion in relation to increasing the retirement age, it would be my judgement at the level of Secretary, notwithstanding changing social values and related legislation, this should not override the right of Government at the level of CEO to terminate an appointee for convenience. If Governments and others wish to retain that right, payment should reflect potential financial loss at this level of seniority and expertise if the Government is to continue to attract mobile executives of the highest calibre to lead significant enterprises within Australia Inc.

## 2. The Marketplace

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### 2.1 Government sector

Arising from the Prime Minister's August 2011 determination, Secretaries' total reward is in the range of \$504,810 to \$539,580. This total reward figure incorporates a prior potential performance bonus payment (addressed at the time of the July 2008 review) which for exemplary performance could have equated to 20 per cent of base salary, though is now absorbed in a Secretary's total fixed remuneration (TFR) to a level reflective of the average performance pay in previous periods (14 per cent of salary).

My research of Australian public sector organisations and entities funded by Government, including business enterprises at both National and State level reveals that governments indicatively reward their most senior executives with total annual remuneration in the broad range of \$400,000 to \$800,000. The total reward for the Chief Executives of some wholly owned Government entities fall outside this range, including organisations in the energy, transport and logistics sectors, in financial services, including funds management, insurance, as well as key Government expenditure areas, for example the NBN Company.

In the Commonwealth arena I note that at the time of preparing this report a number of recently disclosed remuneration levels are above the current TFR of, for example, the Secretaries of the Prime Minister and Cabinet and the Treasury, illustrative of which would include:

- Governor of the Reserve Bank – \$1,049,297<sup>6</sup>.
- Chair Australian Prudential Regulatory Authority – \$800,000.
- Chair Australian Securities & Investment Commission – \$700,000<sup>7</sup>.
- Solicitor-General – \$700,000<sup>8</sup>.
- Some Government owned enterprises for reasons of broad commercial market influences offer annual reward opportunities well beyond the traditional boundaries which have applied to the position of Secretary.
- Managing Director, Medibank Private – \$1,257,200<sup>9</sup>.
- CEO National Broadband Network Company – \$1,962,000<sup>9</sup>.
- Managing Director, Australian Postal Corporation – \$2,737,569<sup>9</sup>.

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<sup>6</sup> The Reserve Bank disclosures comply with the Corporations Act 2011, which is not a requirement of Government Departments, and include elements of employment cost which would otherwise not be reported. I believe other Government owned corporatised entities meet similar compliance standards in respect of their disclosures.

<sup>7</sup> We note that previous appointments to ASIC and ACCC have often been secured from outside long serving senior executives from the public sector

<sup>8</sup> While the position of Solicitor-General is used as a reference point, it is my understanding that Solicitor-Generals in the more recent past have not been career public servants but rather secured from the Bar, including Sir Maurice Byers QC (1973-1983), Dr Gavin Griffith QC (1984-1997), David Bennett AO QC (1998-2008), Stephen Gageler SC (2008-).

<sup>9</sup> I note that the principal executives in these three nominated Government owned enterprises are not long serving public servants but have been secured from private sector organisations to run these substantial Government businesses.

These latter three organisations are clearly very demanding, commercially focused enterprises owned by the Government, with the latter having more than 30,000 staff and 4,400 retail outlets. These CEOs receive reward below counterparts in the private sector, though their base reward levels reflect the expertise required by Government in securing appropriately talented executives to manage commercial enterprises of similar scale and complexity.

I observed in my research that Secretaries may have oversight of agencies where the incumbent Chief Executive's total remuneration is above that of the Secretary, again reflecting the position's requirement for specific skills or expertise where the broader market dictates prevailing remuneration. I have observed arrangements in some States where the most senior officials are paid more highly than Secretaries in the Commonwealth.

As with the Commonwealth, heads of key State Government Departments across the nation are not always paid as highly as executives in Government owned business enterprises within those States. I also observed a degree of variability in the structure of remuneration, including the inclusion and level of at-risk performance pay.

Another role involving considerable challenge is that of Vice-Chancellor in Australia's leading universities. The incumbents of these positions indicatively manage revenues and expenses in excess of \$1 billion, have highly complex tasks involving up to twenty faculties, in a number of cases on multi-campus, with a student body from 20,000 to 50,000 and an academic and support staff in the range of 10 per cent to 15 per cent of student numbers. These executives supervise the management of 'cities' occupied by up to 50,000 people in any one day where they are engaged in the delivery of learning programs at the undergraduate, postgraduate and doctoral level, the oversight of complex research projects and the continuous development and maintenance of infrastructure in an environment where a large proportion of the workforce and stakeholders have a strong sense of self and independence. These roles represent, an appropriate cohort of challenging CEO positions subject to continuous community and Government scrutiny, involving substantial public funding, with a requirement for self reliance and as such represent a useful comparator in this review.

The table below reflects data obtained from universities' most recent Annual Reports (2010 calendar year) and reveals the pay bands within which Vice-Chancellors of our leading institutions are rewarded.

	Revenues \$	Expenditure* \$	Pay Band \$
Australian National University	1,000,570,000	856,566,000	720,000 – 749,999
Monash University	1,531,298,000	1,498,473,000	810,000 – 819,000
University of Adelaide	733,397,000	673,451,000	820,000 – 834,999
University of Melbourne	1,700,478,000	1,608,893,000	870,000 – 879,999
University of New South Wales**	1,420,252,000	1,276,793,000	839,995
University of Queensland	1,503,297,000	1,396,055,000	1,060,000 – 1,069,999
University of Sydney**	1,503,082,000	1,386,975,000	923,679***
University of Western Australia	750,290,000	697,374,000	840,000 – 849,999

\*Expenditure was derived from revenue less pre-tax profit.

\*\*Change to disclosure requirements for Universities in New South Wales

\*\*\*Vice-Chancellor's remuneration includes deemed value of \$60,696 for use of a University provided residence.

## 2.2 International comparators

I note that the level of reward internationally for positions broadly comparable to those of Secretary varies widely, with not all Heads of Government Departments having a long public sector career as a prerequisite for appointment. In the previous US administration the White House clearly stated that a top priority of the President was to select men and women of the greatest ability and highest ethical and professional integrity to serve in policy making and key positions in the Administration. I also observe that the process of confirmation of appointment and the authority to appoint varies between countries.

My research also reveals that pay levels of positions equivalent to that of Secretary in the United Kingdom, Canada and the United States are not aligned to the private sector. Each of the above public service organisations do, however, adopt highly disciplined processes to classify positions and to determine the appropriateness of performance payments.

I note that the remuneration of the Head of a national Government also varies, as does the relationship between the most senior officials in Government and the Head of Government. I observe in this context by way of illustration that the Prime Minister of Singapore receives a much more substantial stipend than the Prime Ministers throughout Europe, the Prime Ministers of the United Kingdom, Japan and Canada or the President of the United States.

It was suggested to me that I should examine the remuneration levels applying in Singapore, as a Commonwealth country in our region. I note in this context that Ministerial salaries in Singapore are benchmarked to the private sector, not an attribute which I observed widely embraced in G20 countries. I further note that bonuses for senior public servants in Singapore can be substantial, though are closely tied to the prosperity of the economy. I observe that alignment with the broader market is a key principle embraced by the Government of Singapore, those principles including:

- “As a civil servant you will be paid at a market rate which is comparable with that of the private sector for an employee with similar abilities and responsibilities. This is necessary for the civil service to attract and retain an appropriate share of the national talent so that Singapore can become one of the best public services in the world..... Your pay is linked to your work performance. This is to motivate and reward for good performance. The civil service is progressing from a seniority based system of fixed annual increments to a system where an individual’s annual increment quantum depends on his potential and performance assessment.....”<sup>10</sup>

My research reveals that senior permanent Secretaries in Singapore may receive annual emoluments in the order of S\$2,000,000 (In April 2011, A\$1 equivalent to S\$1.3). I note that this pay level is benchmarked at two-thirds the average principal earned income of the top four earners in six professions, notably banking, the law, engineering, accounting, and executives in local manufacturing firms and multinationals. I further note that the Government of Singapore has moved to increase the proportion of their senior civil servants’ remuneration to be at risk, with as much as 50 per cent of their annual reward opportunity being performance based, 60 per cent of that being predicated on the individual officer’s performance.

While the above reflects indicative reward levels at the time of conducting my research, I also acknowledge, arising from the at risk or variable proportion, that year on year there can

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<sup>10</sup> [www.vog.gov.sg](http://www.vog.gov.sg) – Ref Public Service Division – Prime Minister’s Office.

be a reasonable degree of volatility in the reward level of a permanent Secretary equivalent serving in the Singaporean Government.

Reflective of pay variability, it was noted at the height of the impact of the global financial crisis that in advice to staff in November 2008, the Singapore Prime Minister's Office announced that Administrative Officers and Statutory Appointment Holders will experience a salary decline of up to 19 per cent due to their pay linkage with Singapore's economic growth. The Government also deferred the scheduled salary adjustment in January 2009, leading to their aggregate reward being below 2007 pay levels. In advice to senior civil servants the Minister in charge of the Civil Service stated: "Public Sector salaries follow the market up and down. The mechanism I introduced last year to link a significant proportion of the salary of senior civil servants to the performance of the economy is working as intended. This mechanism allows salaries to respond more rapidly to market conditions."

In June 2009 the Public Service Division of the Prime Minister's Office advised civil servants that their midyear Annual Variable Component (AVC) would not be paid in light of the country's uncertain economic outlook. It stated that the annual pay of civil servants is pegged to pay levels in the private sector, reflecting that the AVC component in the nation's flexible wage structure is responsive to the nation's economic conditions.

Notwithstanding this dynamic market economy based reward strategy adopted by the Government of Singapore, my research reveals that pay levels of positions equivalent to that of Secretary in the United Kingdom, Canada and the United States are not aligned to the private sector in the same manner as those in Singapore. Each of the above public service organisations do, however, adopt highly disciplined processes to classify positions and to determine the appropriateness of performance payments.

While I have quoted some pay levels for Singapore, my research indicates that the Singaporean approach represents an outlier.

In view of the wide variation in policies, I have formed the view that international practice should not be a primary source of information to guide the Remuneration Tribunal. It is equally my experience that Boards of Australia's leading companies, albeit many have a significant international footprint, determine the reward paid to Australian resident CEOs in a manner which substantially reflects local centrality, not reward levels or opportunities in Europe, including the United Kingdom, or the United States. In the above context I am equally aware that in recruiting from international markets a premium is often paid to secure a senior executive, including the CEO. The recent revaluing of the Australian dollar compared to many international currencies has removed some of this pressure.

A practice of many of the Governments nominated above is to benchmark their positions equivalent to that of Secretary across both the public sector and the private sector, and within the public sector, the inner sector of Government and business enterprises of Government. Benchmark research almost universally has regard to salary levels, the presence of performance pay, conditions of employment and retirement arrangements. In all the research which I observed, benchmarking was local, not international, though where positions were benchmarked to the private sector some of the research data reflected pay practices of international organisations with significant operations in the country.

## **2.3 Australian private sector**

### **2.3.1 Components of Reward**

#### **Total fixed remuneration**

In major companies in the private sector the reward of Chief Executive Officers (CEOs) and their direct reports has traditionally been based on total fixed remuneration (TFR), including contributions to a superannuation fund either in compliance with the superannuation guarantee legislation or in meeting a more generous level of retirement benefit. Senior executives participate in either a defined contribution fund or a defined benefit fund (equivalent in style to those existing in the APS). In the case of defined contributions the superannuation contribution is based on a deemed or nominal salary. In the majority of cases where a defined benefit is offered to a Chief Executive it delivers a retirement benefit subject to a multiple of final average nominal salary times years of service as either a lump sum or pension. In a small number of cases (less than one in twenty) the defined retirement benefit is based on a combination of salary and bonuses averaged over a prior period, usually three years.

### **Variable reward**

In addition to TFR, senior executives in the private sector receive variable reward opportunities, generally strongly performance aligned, though occasionally variable reward is based on length of service. Under variable reward there are annual incentive programs where payments are principally based upon the achievement of business plans substantially predicated on financial returns, also incorporating strategic and other aspects of operating effectiveness, including the management of employee safety and the environment, with customer satisfaction, behavioural attributes, compliance with a code of ethics or other related measures increasingly emerging as either performance gateways or key determinants of an executive's performance assessment.

Annual incentives have traditionally been delivered in the form of cash after the audited accounts of the company are issued, ie when the level of performance is established. Increasingly among major corporations, particularly the top 100 companies, a proportion of the annual incentive has been deferred in the form of a parcel of restricted shares or share rights typically available over one to four years. Performance hurdles or clawback provisions are increasingly applied to annual bonus deferrals. Hurdles would normally relate to sustainability of the company's earnings as distinct from relative total shareholder return, which is a more common performance criteria under an equity based long term incentive plan<sup>11</sup>.

Notwithstanding these emerging provisions in relation to the payment of bonuses, there has been increased comment from shareholders and their advisers expressing concern about the performance standards under annual incentive programs being more closely aligned to shareholder returns. These comments are not unique to Australia, though have in part been introduced internationally where shareholders have an increasing say on pay, and in Australia where the *'two strikes'*<sup>12</sup> legislation and more recently in the United Kingdom where legislation will require Boards to seek re-election annually.

In addition to annual incentive awards, more than 95 per cent of leading public companies have an equity based long term incentive plan whereby executives receive annual, biennial or triennial awards of equity in the form of options or share rights, and occasionally restricted shares, those securities only vesting if future performance conditions are met. The most common performance hurdles include total shareholder return compared to an index such as the S&P/ASX 200 or a peer benchmark such as other materials and resource companies,

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<sup>11</sup> TSR is a measure of the annualised return on investment of a hypothetical \$1000 in a company's ordinary shares. In calculating TSR all capital gains and dividend payments over the period under consideration are incorporated.

<sup>12</sup> The Corporations Act 2001, Chapters 2G and 2M.

either of comparable scale or in a similar resource sector (a relative measure). Other performance hurdles typically include total shareholder return as an absolute measure, relative or absolute share price improvement, earnings per share growth, an internal measure of enterprise value improvement, return on shareholders' equity, return on capital or investment or some other measure relevant to the industry sector.

Following the significant downturn in the global share markets and the challenging economic conditions facing many Australian corporates, incentive plan design is increasingly focusing on the embedded risk in the returns achieved by companies. I anticipate in the triennium ahead a significant proportion of major corporate entities will continue to adjust performance hurdles and financial returns upon which incentives are determined to reflect the embedded risk in those returns. While in the formative phase of the redesign of executive incentive plans, accounting for risk initiatives will need to balance the criticality of entrepreneurial engagement and innovation while adjusting different short term performance outcomes having regard to embedded financial and operational risk.

Reward outcomes at the level of CEO and their direct reports in the Australian economy continue to vary by industry, corporate profit improvement and growth prospects generally reflected in share price movement. For many organisations with a predominant domestic operation CEO reward is also strongly influenced by regional factors, with potential sensitivity emerging in relation to the impact of Government policy initiatives in relation to climate change and changing consumer expenditure patterns.

At the time of originally undertaking my research in relation to work value and remuneration for Secretaries the global financial crisis was top of mind. In late 2011, when my advice on remuneration is being finalised, the Australian economy is experiencing a dual or multi speed business environment where different sectors are being affected by global financial volatility which is having an impact on exports, Australia's terms of trade and raw material substitution at a time when an increasing proportion of consumer expenditure is being managed in an online environment, a factor which five years ago was not influencing reward patterns or sector financial prosperity to the extent that it is in late 2011.

In addition to the above, many senior executives, though rarely CEOs, have in the recent past participated in a retention award program whereby they would receive a fixed number of shares or a fixed cash amount for staying with the organisation for a defined period of time. I note that Governments throughout Australia have adopted retention awards in specific settings for similar purposes, both within their core operations and also within enterprises which Governments are seeking to corporatise and potentially privatise.

### **2.3.2 A foundation for comparison**

Given my view that the primary difference and the most significant difference between the role of a major company CEO and that of a Secretary relates to the former's engagement in business growth, value enhancement and achieving profit and other return objectives, I formed the view that the basis for comparison of private sector reward and that of the position of Secretary should ignore those elements of private sector reward which reflect performance, either by way of a cash incentive based on achieving annual financial, strategic and operational objectives or an equity based incentive where the Chief Executive, with shareholder approval, participates in the growth in enterprise value over time as a result of meeting certain performance hurdles.

In exploring the relevance of different comparators, and again having regard to the nature of a Secretary's engagement in the review of Government expenditure, I considered the financial and employment dimensions of Australia's leading companies having regard to comparability of operating expenditures, while also being mindful of the level of Government

appropriations under the stewardship of Secretaries, together with revenues collected by Departments for services provided.

The tables below set out the distribution of metrics for the positions of Secretary across all twenty Departments, as well as those positions of Secretary classified in either Level 1 or Level 2. The parameters adopted draw upon the 2012 financial year budget estimates of each Department. In respect of comparators I have drawn information on the financial returns of the top 200 companies listed on the Australian Securities Exchange in respect of financial years ending up to 30 June 2011. In most distributions it will be observed that financial metrics are skewed above the median, with outliers having a significant impact on averages.

### 2011/2012 Budget Parameters of Government Departments

	75 <sup>th</sup> Percentile \$ millions	Median \$ millions	25 <sup>th</sup> Percentile \$ millions	Average \$ millions
<b>All Departments</b>				
Revenue	716	403	196	1,551
Direct Expenditure	775	446	184	1,647
Appropriations	21,791	3,658	1,937	18,036
<b>Classification Level 1*</b>				
Revenue	784	706	549	3,022
Direct Expenditure	922	762	588	3,219
Appropriations	48,457	42,406	6,520	36,109
<b>Classification Level 2*</b>				
Revenue	403	231	136	348
Direct Expenditure	446	216	136	360
Appropriations	3,658	3,022	1,137	3,250

\* See Appendix A.

### 2010/2011 Financial Parameters of Companies in the ASX ranked 1 – 200

	75 <sup>th</sup> Percentile \$ millions	Median \$ millions	25 <sup>th</sup> Percentile \$ millions	Average \$ millions
<b>ASX 1 - 10</b>				
Revenue	54,783	42,717	33,150	42,699
Expenditure *	45,980	36,849	29,749	33,605
<b>ASX 1 - 25</b>				
Revenue	38,305	11,673	4,570	21,613
Expenditure *	33,748	10,373	3,777	17,356
<b>ASX 1 - 50</b>				
Revenue	14,298	4,506	1,903	12,662
Expenditure *	13,006	3,858	1,512	10,363

	75 <sup>th</sup> Percentile \$ millions	Median \$ millions	25 <sup>th</sup> Percentile \$ millions	Average \$ millions
ASX 11 - 50				
Revenue	7,220	3,194	1,105	5,153
Expenditure *	6,427	2,650	802	4,553
ASX 26 - 75				
Revenue	4,150	2,066	750	3,723
Expenditure *	3,729	1,768	581	3,434
ASX 11 - 100				
Revenue	4,419	1,958	715	3,702
Expenditure *	3,930	1,687	603	3,349
ASX 41 - 90				
Revenue	3,559	1,523	653	3,068
Expenditure *	3,220	1,305	517	2,867
ASX 51 - 100				
Revenue	2,927	1,317	593	2,541
Expenditure *	2,630	1,132	510	2,386
ASX 76 – 125				
Revenue	1,862	749	250	1,339
Expenditure	1,691	644	174	1,257
ASX 51 – 150				
Revenue	1,890	726	217	1,702
Expenditure *	1,679	623	162	1,585
ASX 101 - 200				
Revenue	843	397	119	735
Expenditure *	751	335	123	686

\* Major public company expenditure was derived from the revenue figure less pre-tax profit.

It will be noted that Secretaries as a group have accountability for the oversight of significant National expenditure, often disbursed through Government agencies within their portfolio, though subject to the Financial Management and Accountability Act 1997 (Cth). My statement of appropriations in this latter context has not included appropriations within a Secretary's portfolio which are subject to the Commonwealth Authorities and Corporations Act 1997 (Cth). The expenditure obligations of Australia's top 10 corporations are not dramatically out of alignment with the appropriation obligations to the top Departments (Level 1) in which Secretaries have stewardship. These '*expenditure values*' are very much diminished by the Departments of the Prime Minister and Cabinet and the Treasury which do not have direct oversight of significant appropriations nor do they have substantial staff numbers.

The expenditure of ASX companies ranked 1 to 25 also reflects some of the appropriation expenditure attributes of the top level of Secretary positions. The attributes of Secretaries classified in Level 2 straddle a much wider group more broadly indicative of the mid 100 companies in the ASX 200 having regard to their composite financial management role.

For the purpose of developing a market perspective I have reported information on the median, 25<sup>th</sup> and 10<sup>th</sup> percentiles, as well as the average among comparator groups in relation to total fixed remuneration. Providing 10<sup>th</sup> percentile data was primarily to highlight the relative market positioning of current reward levels of Secretaries of Australian Government Departments. I have also provided graphs in relation to a variety of comparators to indicate the proportion out of 100 per cent of total reward that fixed remuneration represents of a Chief Executive emoluments in Australia's top companies (see Appendix C - Total Reward in the Private Sector).

### Total Fixed Remuneration (TFR)

CEOs by S&P/ASX Rank	Median \$	25 <sup>th</sup> Percentile \$	10 <sup>th</sup> Percentile \$	Average \$
1 – 10	2,836,548	2,700,750	2,574,505	2,879,445
1 – 25	2,456,094	2,120,310	1,529,721	2,637,469
11 – 25	2,235,000	1,869,431	1,007,889	2,492,284
1 – 50	2,056,167	1,554,749	1,017,222	2,208,751
11 – 50	1,877,461	1,491,039	1,000,500	2,057,845
26 – 75	1,643,982	1,090,152	772,446	1,625,686
1 – 100	1,795,383	1,042,829	726,687	1,806,250
11 – 100	1,661,632	1,007,828	657,700	1,689,879
41 – 90	1,515,280	927,500	615,502	1,447,272
51 – 100	1,252,786	839,365	575,600	1,347,586
76 – 125	1,150,816	715,525	459,372	1,161,159

By way of comparison, particularly for the unique roles of Secretary of the Departments of the Prime Minister and Cabinet and the Treasury, I have provided information on the second highest paid executive in the top 25 listed companies. I have also provided information on the second highest paid executive in those companies ranked 1 – 50 and 11 – 50.

### Total Fixed Remuneration (TFR)

2ICs in S&P/ASX by Rank *	Median \$	25 <sup>th</sup> Percentile \$	10 <sup>th</sup> Percentile \$	Average \$
1 – 25	1,209,479	856,482	676,439	1,245,552
1 – 50	967,897	696,062	566,070	1,041,214
11 – 50	852,641	663,141	510,144	922,520

\* 2IC refers to the second highest paid executive in the band of listed ASX ranked companies.

### Comment on the above data

Given the view which I have expressed in relation to the comparability of the position of Secretary and that of Chief Executive Officer, I formed the judgement that a Secretary did not have the same obligations in relation to creating enterprise value, achieving or improving profitability or expanding their organisation's footprint in the same way as a CEO in the private sector. Accordingly, those elements of private sector reward which are intended to

be performance aligned, in my judgement do not have a relevance for the position of Secretary.

It will be observed from the above research data on averages that senior executive fixed remuneration in the private sector is generally skewed above the median, with the gap between the 75<sup>th</sup> percentile and the median being significantly greater than the gap between the median and the 25<sup>th</sup> percentile, with many outliers above the 75<sup>th</sup> percentile influencing the proximity of the average and the median.

### 2.3.3 Comparison with the heads of large professional firms

Another comparator for the position of Secretary would be the CEOs of leading advisory firms.

The leadership positions in Australia's largest advisory or consulting organisations, while having a broad administrative accountability, do have an engagement in business development, though in this context are supported by marketing and business development teams. Their earnings would normally reflect drawings influenced by the practice's capacity to pay in the case of partnerships and their total reward opportunity would be influenced by the firm's level of profitability. The Chief Executive Officer in the majority of leading practices would have stewardship of an organisation offering a diversity of services with engagement across all industries, including many clients with a substantial international presence. These firms also have considerable engagement in the Government sector, advising on a myriad of policy, financial and operational issues at Federal, State or local level, where Departments or portfolio agencies seek external support in their review of key strategic, policy and operational challenges before them.

A number of these organisations have international parent firms, though in the case of many law firms, they are Australian headquartered.

A feature of reward practices in these organisations is that the CEO is not always the most highly paid, as payment will reflect a combination of position accountability and contribution to the firm's revenue and profitability. In this context rainmakers with significant professional expertise would often be paid more highly than the CEO who, while highly skilled in a particular area of the firm's practice, has an engagement more reflective of a CEO and less reflective of a practice leader in the context of managing account relationships or client delivery on major projects.

Having regard to organisations with substantial revenues and expenditures, with significant staff numbers (often numbering several thousand), it is my understanding that the indicative, though wide, band of remuneration for CEOs and senior practice partners would be above the payment of Vice-Chancellors and be indicatively pitched in the range of \$1,000,000 to \$2,000,000, though there are clearly outliers to this range. Professional firms, in retaining their most able advisors, also need to be competitive with their counterparts in major corporations and substantial Government organisations with whom their senior staff consult and are actively engaged in the delivery of successful outcomes to meet their client needs at any point in time. **It is my understanding that salaries, as distinct from total reward, of senior executives in professional practice would typically be in the range of \$500,000 to less than \$1,000,000, with performance bonuses and partnership returns delivering rewards in the range specified above.**

A primary (but not universal) difference between the majority of these substantial professional firms and major corporations, is that the Chief Executive's and senior practice partners earnings are in part reflective of the firm's success **(note comment above)**, though

on leaving they do not retain a financial interest in the firm, nor do they have a tangible security to sell, unlike their counterparts in major listed public companies.

Given that the Australian Government spend tens of millions of dollars with external advisory firms, Secretaries and Deputy Secretaries or Program Directors in Commonwealth Departments work closely with these partners and indeed in substantial part direct and supervise their input and their final advices. While not necessarily having the resources of substantial consulting, engineering and legal practices, Department Secretaries are accountable to their Minister for oversighting the quality and value of work undertaken by local and international advisory firms.

#### **2.3.4 Investment banks**

The payment arrangements of Chief Executives in these large professional organisations differ again from their counterparts with comparable professional skill and expertise retained by leading investment banks, both local boutique operations and those forming part of international enterprises. In the latter fixed remuneration is often modest and less than \$750,000 per annum, though total earnings are very much aligned to profit sharing and the value of transactions in which partners or executive directors, including Chief Executives, might participate.

The traditional level of earnings of Chief Executives, partners or executive directors in leading investment houses has been well publicised and while fixed remuneration is traditionally modest, earnings in good years amount to many multiples of TFR. Reward practices in these entities often require deferral of incentive payments generated in any one financial year for a number of future financial years, either as cash or as an equity interest in the firm, be it listed or unlisted. Post the global financial crisis earnings of senior executives in local and international investment banks and investment advisory firms have been substantially below earnings in the triennium preceding the GFC. This particular cohort of highly qualified professionals is not considered a relevant comparator for the position of Secretary.

#### **2.3.5 Best fit comparators**

Having regard to the obligations of Secretaries in both classification levels, I have formed a view that the most appropriate comparator for the two unique roles in Level 1, that of the Secretary of the Department of the Prime Minister and Cabinet and the Secretary of the Department of the Treasury, is the second highest paid executive in the top 25 corporations as one key and unique indicator.

In respect of the generic Level 1 classification I formed the view that an amalgam of the second highest paid executive in those companies ranked between 1 and 50 and CEOs in the ASX 100 ranked between 40 and 90 represented the best comparator group. This latter combination has due regard for both operating expenditures and appropriations in respect of the majority of positions classified at Level 1 and the level of stewardship of Government appropriations.

For the second cohort, that is those positions of Secretary in Level 2, it was my judgement that an appropriate comparator would be the second highest paid executive in those companies ranked 11 – 50 and having regard to an aggregate circumstance of direct operating expenditure and stewardship of Government appropriations it was my judgement that the relevant cohort at the CEO level for these positions were companies ranked from 75 – 125.

### 3. Recommendations

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#### 3.1 Introductory remarks

As noted above, the pay determination for the office of Secretary has in recent times established two classification levels, with Secretaries being paid a fixed sum on the basis of their relative level. I also observe that the gap between the highest paid Secretary and the least well paid Secretary at present is \$34,770, with the lower pay level representing 93.5 per cent of the highest pay level. This relationship has not varied significantly over the past ten years. In 1999 the gap was \$18,000 and Level 2 Secretaries were also paid at around 93.5 per cent of Level 1 Secretaries. Given my assessment of the cohort of Secretaries, even though they all have an engagement in *'Whole of Government'* issues, this gap is modest. Accordingly, as noted above, I have suggested two classification levels with further refinement in reward arrangements. In accordance with that recommendation the material below sets out discrete payments for each level.

There are a number of alternate approaches which I believe the Government could consider in managing pay differentials between Secretaries. An alternate to the current fixed pay level construct would be to establish a base level of fixed annual remuneration for a Secretary and establish loadings by classification level reflecting standing and recency of appointment and period of service in the position of Secretary at the classification level.

I note that the Tribunal in addressing PEOs in Government Business Enterprises (GBEs) have over the period established a remuneration framework within which GBEs reward their PEOs. I note that the framework embraces a five level classification structure incorporating a degree of salary overlap, with each pay band being adjusted from time to time having regard to relevant reference marketplaces. I note in this context that the Tribunal provided for the GBE to pay up to an additional 5 per cent above the classification reference rate.

I further note that without the Tribunal's approval an appointee in their first twelve months of service cannot receive remuneration above the reference rate, though the GBE can establish their total remuneration at a level 10 per cent below the reference rate. This approach embraced by the Tribunal provides employer bodies with flexibility.

The total remuneration framework also incorporated at risk performance pay opportunities subject to classification level and provided scope for business use of a vehicle. In addition, the Tribunal's determination referenced a construct of total remuneration consisting of a total employment cost exclusive of performance pay, with total remuneration inclusive of performance pay.

As stated above, arising from this language and the change in the foundation of Secretaries' remuneration with effect from July 2008, it is my recommendation that a Secretary's remuneration in its present form be referred to as 'Total Fixed Remuneration' in order not to be confused with the universal nomenclature of 'Total Remuneration' which includes an element of at risk performance pay. In this context, in other areas of the Tribunal's jurisdiction I would propose that they nominate the elements of remuneration exclusive of at risk performance pay moving forward as 'Total Fixed Remuneration' (TFR) representing the total value of salary together with superannuation and non-cash benefits, with 'Total Remuneration' (TR) incorporating TFR and at risk performance pay.

Adopting nomenclature embraced by the Tribunal, I have also formed the view that the use of the term 'reference rate' retains relevance for the position of Secretary, either within a total fixed remuneration band structure or a structure which establishes a base rate, the

reference rate with loadings having regard to classification level. Factors which would impact on the Secretary's TFR would include length of service in the position of Secretary and assessed contribution and expertise at the classification level.

While in respect of PEOs the Tribunal provide GBEs with the opportunity of determining remuneration at up to 10 per cent below the reference rate, I have adopted a view that a Secretary, once assuming the base classification role (Level 2) of Secretary, would be paid at the reference rate, reflecting the position's accountabilities and required engagement in supporting the Government of the day in both portfolio and '*Whole of Government*' stewardship, their tenure being determined by the Prime Minister of the day on advice of his or her Minister and the Secretary of the Department of the Prime Minister and Cabinet.

In this context, in relation to both separation and payment above or below the reference rate, it would be my recommendation that a select committee consisting of the President of the Remuneration Tribunal and the Public Service Commissioner be formed to assist the Secretary of the Department of the Prime Minister and Cabinet. In respect of the positions of Secretary of the Department of the Prime Minister and Cabinet and the Department of the Treasury, it would be my recommendation that the Tribunal be charged with this responsibility and in its independent capacity determine appropriate remuneration for both positions having regard to factors before them at the time of each review.

While not specifically referencing performance levels previously established for the position of Secretary and outlined by the Tribunal in respect of PEOs, the TFR bands recommended for the position of Secretary or loadings suggested clearly reference elements of competence from effective through to exemplary, with a view that reappointment of a Secretary for a further term would reflect performance which demonstrated a high degree of professionalism and judgement and a significant contribution to public service leadership, policy development and financial management.

As with PEOs, it would be my expectation that the reference rate would be reviewed annually by the Tribunal and their recommendation adjusted as appropriate in accordance with relevant external benchmarking and other factors considered appropriate by the Tribunal.

### **3.2 Remuneration structure**

It was my view that the current single payment strategy for each classification level did not provide adequate differentiation to reflect all the attributes before the Government of the day in adjudicating equitably on a Secretary's total fixed remuneration level. It was equally my observation that the single point payment arrangements did not provide an appropriate reward structure to accommodate appointments which clearly reflect an uplift in accountability across departments or from the role of Deputy Secretary or Associate Secretary in a major department. If the position of Secretary were considered as a developmental cohort at the most senior leadership level in Government it would be my judgement that a three or four level structure could be considered, though in the pay bands set out below, the Tribunal have flexibility, being able to differentiate a Secretary's payment level in accordance with their experience and acknowledged expertise.

While a two level classification and supporting pay structure has been developed as a guide to the Tribunal to reflect the breadth of the various Secretaries' roles, it is my judgement that the remuneration structure outlined below will provide the Government with greater flexibility in recruitment from within and external to the APS.

It is my view that a range of TFR should be available to Government in order to enable appointees to be rewarded and recognised in a framework which has the capacity within a pay band by classification level to respond to movement in portfolio accountability, while concurrently being adaptive to the Government's need to retain highly experienced and long serving Secretaries.

In my judgement it also accommodates movement to both refresh and invigorate the performance of experienced Secretaries providing the Government with experienced talent for senior appointments while accommodating lateral movements, including overseas appointments, which are considered by the Government of the day as beneficial in the context of *'Whole of Government'* management, executive development and changes in the portfolio mix under the stewardship of a Minister as Governments change the way in which they endeavour to achieve their priorities from time to time.

In respect of each classification level I have nominally provided two reference rates, one on appointment and the other, or the midpoint of the discrete ranges, either on reappointment or after three years in the role which represents elements of the strategy adopted by the Remuneration Tribunal in relation to PEOs where a payment on appointment up to 10 per cent below the reference rate is available to the Government and/or the Board of the organisation in relation to the appointment of their Chief Executive Officer.

I also observed, in undertaking my review of remuneration across all public sectors in Australia, that there was a close relationship between levels of reward in the Commonwealth and those at State level, the latter often being informed by decisions in respect of pay arrangements of the former. I noted at State level that it was not always the departments with a core policy advisory role that were seen to be the most onerous or highly paid, but rather those portfolios overseeing substantial expenditures concerned with Education, Health and Transport.

### 3.2.1 Pay bands

I am of the view that the classification or pay model should provide the Government with flexibility in moving Secretaries from one portfolio to another without perceived disadvantage to the Secretary or the Government. In this context I believe there would be merit in providing a minimum of two payment increments for each classification to accommodate mobility while providing the Government with flexibility in choosing appropriately experienced officers to fulfil varying roles over an extended career in the APS.

While Secretaries in the twilight of their careers may assume less onerous roles in some respects, I have also provided for the prospect that these long serving senior officers in Government employ could be highly effective in mentoring and indeed coaching up-and-coming talented officers who represented the future leadership in the Australian public sector, for overseas appointments, appointments as CEOs of portfolio agencies or as Secretaries, providing for the prospect of movement, for example, from a portfolio agency to a Department or vice versa, or from an overseas ambassadorial appointment to a Secretary or portfolio agency appointment.

I further assumed that the Secretary of the Department of the Prime Minister and Cabinet would be unlikely to be appointed to any other role in Government once assuming that role and that the Head of Treasury, unless appointed to lead the Department of the Prime Minister and Cabinet, would be unlikely to assume any other Secretary role in Government, though in the past I observe that the Head of Treasury has been appointed to the position of Governor of the Reserve Bank (at a time when the regulatory accountability was retained by the Reserve Bank), a role today which may be considered more as a lateral move.

### 3.2.2 Adoption of total remuneration bands by classification level

Following my comprehensive research of public sector pay practices in Australia, international public sector reward practices and a review of private sector pay practices in Australia, I have established a reference rate for each classification level. I have adopted a range not dissimilar from that proposed by the Tribunal in relation to PEOs. The reference rate in the proposed structure is the minimum rate.

The first step in the pay band is designed to accommodate accomplished Secretaries at the time of their reappointment after between three and five years' service as a Secretary, reflecting an increment of approximately 7.5 per cent at the time of reappointment. It would be considered highly improbable that a Secretary reappointed to the role in the same classification level would not be recommended to receive the initial incremental step, though I believe it is important that this decision remains the accountability of the Review Committee consisting of the Secretary of the Department of the Prime Minister and Cabinet, the President of the Remuneration Tribunal and the Public Service Commissioner.

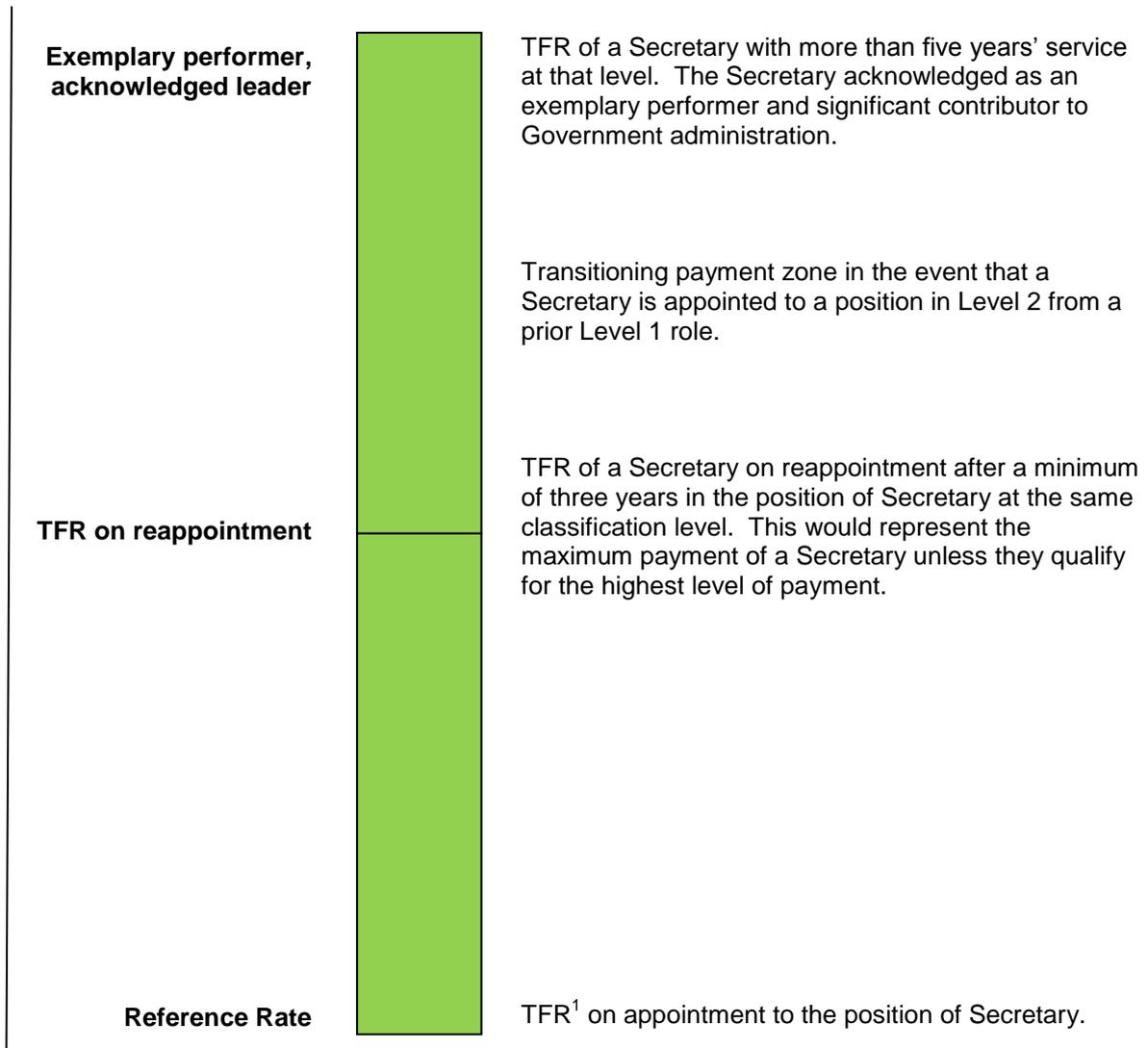
The maximum of the pay band has been designed as a pay level for highly accomplished and long serving Secretaries who are regarded as promotable to a higher level and/or are regarded as being distinguished members of the Government's cohort of Secretaries having regard to their long service and significant accomplishments.

Should a Secretary be moved laterally during an initial appointment period I would not anticipate an adjustment to their total fixed remuneration, though after five years' service reflecting fully effective performance in the office of Secretary I would anticipate that on the recommendation of the Secretary of the Department of the Prime Minister and Cabinet, in consultation with others as appropriate, that such an adjustment would be made.

Where a Secretary in the final years of their service in the APS is appointed to a position at a lower classification and is paid beyond the exemplary performance level of the lower classification, it would be my recommendation that they receive no further increases but that their TFR is not reduced but rather absorbed over time with the benefit of incremental annual or other market adjustments, in this way not impacting unreasonably on their retirement benefit. I realise that such an appointment may be made to provide seasoned management skills where a Department has serious management problems rather than a perceived demotion.

## Diagrammatic illustration

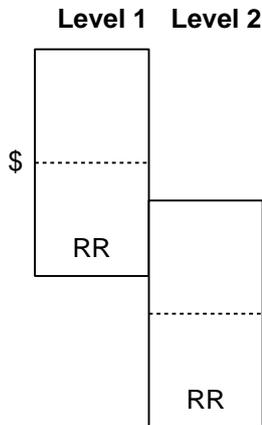
### INDICATIVE SECRETARY TFR POSITIONING IN BAND



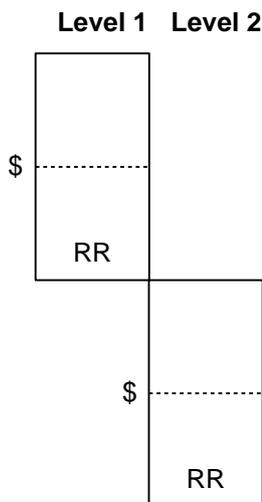
<sup>1</sup> Total Fixed Remuneration including base salary, superannuation contribution cost and the value of non-cash benefits.

Reflective of the pay band construct, the diagrams below illustrate a construct of overlapping payments (5 per cent) within a pay band or discrete separated payment levels. Payment of a Secretary within a pay band is intended to reflect the Secretary's experience and contribution to Government and/or recency of appointment, as illustrated above.

### Overlapping pay bands



### Discrete pay bands



**RR: The Reference Rate.**

In the event that the Tribunal determine a single pay point for each classification level of Secretary, my recommendation would be they adopt the indicative midpoint of the pay bands highlighted above in respect of all positions of Secretary, excepting the positions of Secretary of the Department of the Prime Minister and Cabinet and the Department of the Treasury which would be independently determined, in accordance with my recommendation, by the Remuneration Tribunal.

### 3.2.3 Competitive positioning of Secretary remuneration

Given my observations in relation to the differences in accountability and attributes of a Chief Executive in a major corporation and a Secretary, as well as the commonality in their respective accountabilities, it is my judgement that the foundation for the payment of a Secretary having regard to the attributes required to successfully fulfil the role should have

regard to pay parameters for individuals of comparable experience and skill, though not have regard to the rewards received by Chief Executives and other senior executives in the private sector reflecting their engagement in creating value through taking market risks. In this respect the remuneration arrangements, in my judgement, appropriate for the position of Secretary should have principal regard to a broad market competitive level of fixed annual remuneration (TFR), ignoring the proportion of private sector reward which is performance aligned, including access to company shares and payment of annual bonuses.

I believe it is, however, important to have regard to both the changes in the level of remuneration in the marketplace generally and the reweighting over the past decade in particular between guaranteed or fixed remuneration and at risk or variable performance aligned remuneration. In relation to the nation's largest companies it would also be prudent to have regard to the growth in those companies, both domestically and internationally, measured in terms of annual revenues, assets managed, shareholder funds and profits secured (see Appendix D).

It is in the value creation component of executive reward that I believe Secretaries rightly do not participate, though in every other respect, in order to attract executives with the leadership attributes and of a calibre capable of assuming accountability in the administration and governance of the national Government, reward should reflect an appropriate standard. In this context, in my judgement it is right and proper to have regard to prevailing rates of reward for the most senior executives in the private sector. It is important as well to have regard to the reward levels established for senior executives employed by Governments with stewardship of corporatised enterprises dealing with a myriad of service provisions and the management and oversight of strategic assets.

At the time of undertaking my research those executives in the employ of the Australian Government managing the most substantial enterprises were in receipt of fixed annual remuneration from around \$600,000 to in excess of \$1,000,000, a range which I believe appropriately reflects the broader marketplace and the accountabilities and expertise required by Government in providing effective stewardship over their assets in the delivery of a variety of services to both Government and the Australian community.

A key question which needs to be addressed by Government is its market positioning having regard to the absence of at risk or variable pay to attract and retain executives of the highest calibre to fulfil the role of Secretary while at the same time retaining a cohort of executives with a diversity of experience of work in Government at the level of Associate Secretary, Deputy Secretary and Assistant Secretary. The management and development of human capital at senior executive levels in Government is critical (particularly given the history of external appointments) to ensure that future Governments always have access to high calibre executives to fulfil the role of Secretary.

My research revealed that the relative competitive positioning of Secretaries' remuneration had declined over the last generation from at or around the market 25<sup>th</sup> percentile (even with the inclusion of performance pay) to the first decile (the lowest ten per cent) in respect of the most complex and onerous roles. Such a strategy, in my judgement, would not ensure that the Government of today or future Governments would have access to individuals of the highest calibre. I note that over the past fifteen years only three Secretaries have been appointed from outside the Australian public sector's employment.

If the Government were to embrace earlier competitive positioning in respect of fixed remuneration while ignoring performance aligned reward as they move forward, the retaining of the long established market positioning pay profile of Secretaries in the second quartile of a broad national market would require an increase in current rates of reward. Aligning a

Secretary's emoluments with those of the Chief Executives of the more substantial portfolio agencies and statutory bodies within the Australian Government and State Governments (where clearly the judgement has been traditionally to align executive reward in a number of these organisations to a private sector marketplace) would also require an increase in prevailing levels of TFR. It would not in this context, however, be my judgement that Secretaries should be subject to annual performance awards by way of incentive, even though this may well be relevant in certain Government corporatised or statutory bodies where independent boards as distinct from members of parliament set standards and assess performance.

I also considered current total fixed remuneration arrangements, including both the gap between positions of Secretary in different Departments and that between the position of Secretary and their direct reports. It appeared to me that in both respects the present differential is too narrow to reflect actual differences in accountability. At the time of undertaking this research the gap between a Level 1 and Level 2 Secretary in terms of total fixed remuneration was less than \$35,000. In my judgement this gap should be substantially greater, though not necessarily a gap reflective of the pay differential in Government between its most substantial corporatised entity and entities of lesser scale.

I acknowledge in this context that certain Government owned enterprises may well need to compete for high calibre staff in markets which are subject to very different supply and demand pressures for talent when compared to the position of Secretary. Those industry sectors might include energy, financial services, health, engineering, infrastructure, telecommunications, media, logistics and transport, a number having no direct relevance to the position of Secretary, though some may well have relevance in varying degrees to certain Government portfolios. Again, their relevance would be subject to the Government's strategy in recruiting Secretaries to assume a primary leadership obligation to be the Government's principal adviser on policy and Government strategy as distinct from those directly managing the development of assets or the delivery of services to the Government itself, the community or business.

#### **3.2.4 Pay relativity**

On the basis of my research I observed that pay relativity within the Australian Government in terms of total remuneration between the position of Secretary and Deputy Secretary/Associate Secretary reflected an indicative relationship of the direct report receiving 65 to 75 per cent of the reward of Secretary. This clearly varied by Department and in some environments I observed a closer relationship arising from external recruitment challenges for specialist staff and in others a broader gap, in part reflected by the number of direct reports to the Secretary.

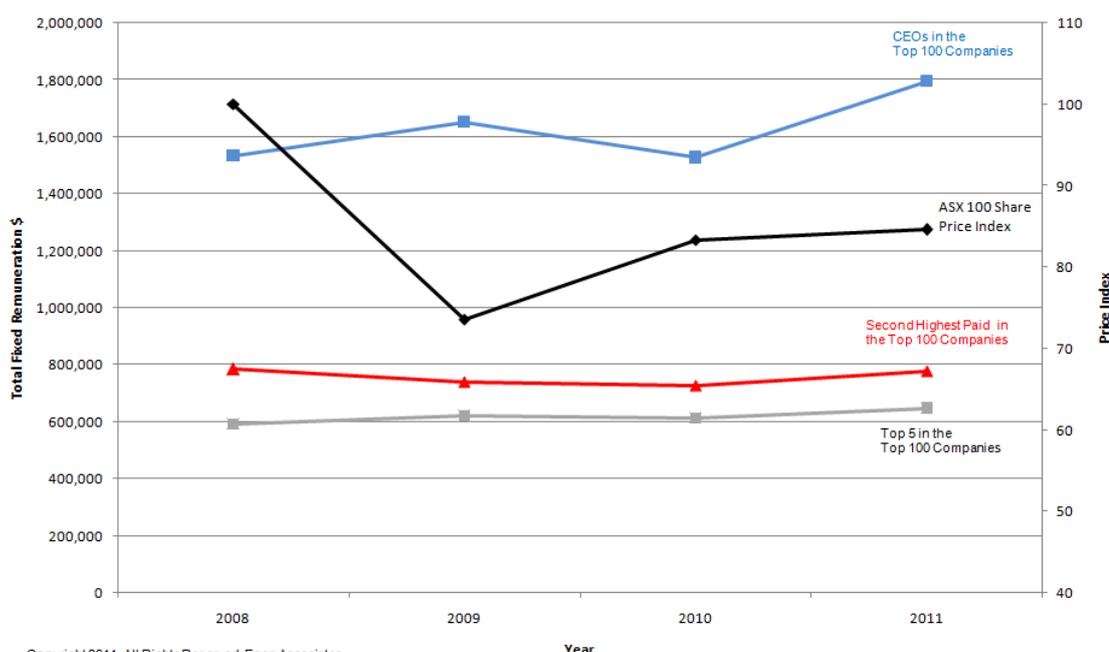
Published Annual Reports of Government owned organisations reveal a much wider gap than that which is embraced within primarily Canberra based Government Departments, with statutory or corporatised Government agencies adopting a position between the private sector and Government Department pay structures. The pay relativity between Chief Executive Officers, their 2IC and top five direct reports among Australia's leading companies are summarised in the table below and set out graphically in Appendix C.

	TFR Relativity between the CEO and the 2IC		TFR Relativity between the CEO and their Top 5	
	Median	Average	Median	Average
Top 25	49%	47%	39%	39%
26 – 75	43%	48%	34%	40%
50 – 150	53%	47%	40%	36%
Top 100	43%	49%	36%	40%
Second 100	61%	58%	51%	46%

The above only reflects the differential in total fixed remuneration not total annual remuneration (TFR plus cash bonuses) where the gap widens with the increased emphasis on at risk performance payments for CEOs in the private sector.

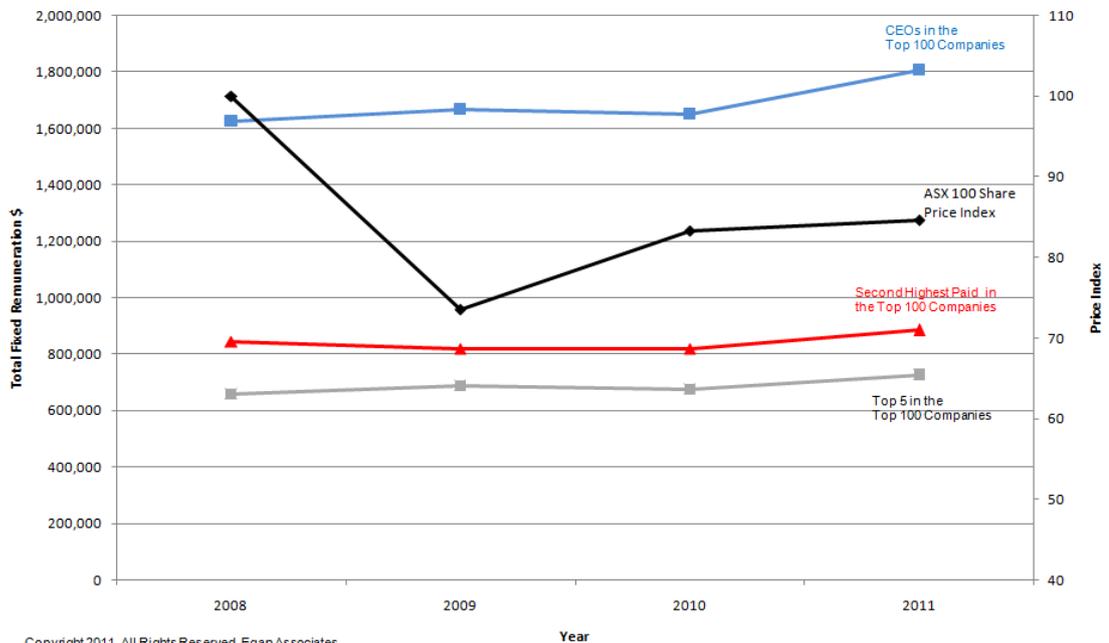
The graphs below highlight the prior three years relationship between the annual cash based remuneration of CEOs of Australia's top 100 companies, the 2IC and top 5 highest paid executives total fixed remuneration and also compares these relationships with movement in the ASX 100 share price index. The graphic material portrays both median and average total annual remuneration payment levels.

**Median** Total Fixed Remuneration of the Top 100 Companies  
Chief Executive Officer, Second and Top 5 Highest Paid Executives  
30 June 2008 - 30 June 2011



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Companies are ranked as at 30 June of each year (and excludes property trusts, funds, overseas entities and subsidiaries).  
ASX 100 Price Index based on a value of 100 at 30 June 2008. 22 trading day smoothing applied.  
Source: Thomson Reuters Datastream

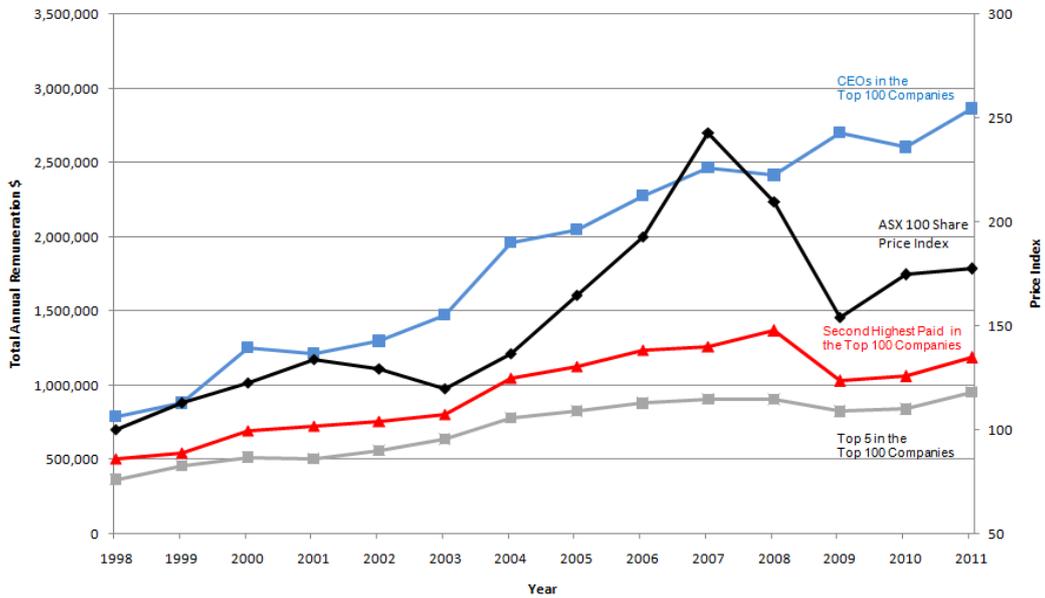
**Average Total Fixed Remuneration of the Top 100 Companies  
Chief Executive Officer, Second and Top 5 Highest Paid Executives  
30 June 2008 - 30 June 2011**



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 Companies are ranked as at 30 June of each year (and excludes property trusts, funds, overseas entities and subsidiaries).  
 ASX 100 Price Index based on a value of 100 at 30 June 2008. 22 trading day smoothing applied.  
 Source: Thomson Reuters Datastream

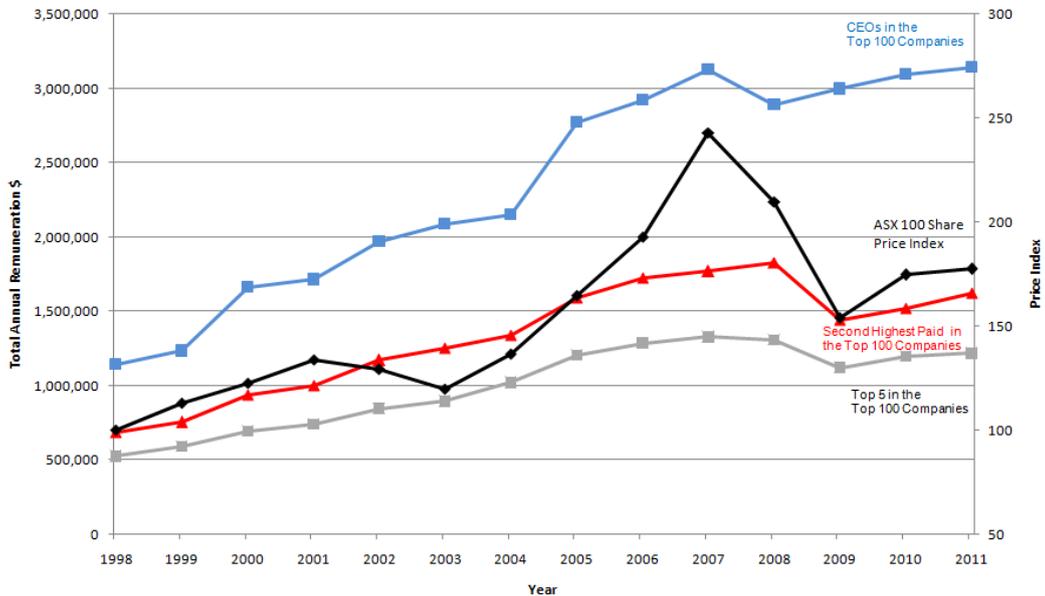
The graphs below highlight the prior ten years relationship between total annual remuneration (fixed remuneration plus annual cash bonuses) for the CEOs of Australia’s top 100 companies, the 2IC and top 5 highest paid executives. The illustration also reflects movement in the ASX 100 share price index over the decade. The data excludes rewards arising from participation in long term equity based incentive programs. The graphic material portrays both median and average total annual remuneration payment levels.

**Median Total Annual Remuneration of the Top 100 Companies**  
 Chief Executive Officer, Second and Top 5 Highest Paid Executives  
 30 June 1998 - 30 June 2011



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 Companies are ranked as at 30 June of each year (and excludes property trusts, funds, overseas entities and subsidiaries).  
 From 1998 to 2003, Executive Remuneration Bands were used.  
 From 2004, Executives' Actual Total Annual Remuneration were used  
 ASX 100 Price Index based on a value of 100 at 30 June 1998. 22 trading day smoothing applied. Source: Thomson Reuters Datastream

**Average Total Annual Remuneration of the Top 100 Companies**  
 Chief Executive Officer, Second and Top 5 Highest Paid Executives  
 30 June 1998 - 30 June 2011



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 Companies are ranked as at 30 June of each year (and excludes property trusts, funds, overseas entities and subsidiaries).  
 From 1998 to 2003, Executive Remuneration Bands were used.  
 From 2004, Executives' Actual Total Annual Remuneration were used  
 ASX 100 Price Index based on a value of 100 at 30 June 1998. 22 trading day smoothing applied. Source: Thomson Reuters Datastream

To further amplify the total reward arrangements in the marketplace in the 2011 calendar year the graphics appended (Appendix B) reveal the proportion of TFR of the total reward opportunity, including the value of annual incentive payments and equity based long term

incentive values for CEOs and the second highest paid executives in a selected range of ASX ranked companies

The paragraphs below deal with broader employment issues which in my judgement require attention in ensuring that any significant adjustment to reward arrangements and conditions of employment of Secretaries embrace integrity in the widest sense and the management of reward on a fully costed basis reflecting equitable treatment across the cohort of Secretaries.

### **3.2.5 Managing total fixed remuneration**

Under present arrangements a Secretary's remuneration reflects a deemed contribution to superannuation which does not reflect actual cost of participation in the varying superannuation plans in which Secretaries participate. Discussions with Secretaries also revealed that the cost of a supplied vehicle to their remuneration package was high compared to provisions elsewhere in the public sector across Australia and that parking costs were variable and were required to be met within their remuneration package. In the latter context variability was primarily a factor of the location of the Department which the Secretary served.

### **3.2.6 Superannuation**

I note under current arrangements that the determination of a Secretary's superannuation salary is fixed at 80 per cent of total fixed remuneration. I believe that this strategy is fair to all Secretaries in that the base for the determination of their contribution and/or the Government's contribution is fixed. I comment below in relation to transition arrangements on the level of the superannuable proportion of a Secretary's fixed remuneration and note that historically the proportion has varied over the last decade from 70 per cent to the current level of 80 per cent. At a senior executive level in the private sector 80 per cent would be regarded as a high proportion of TFR to be superannuable, whereas 70 per cent would be closer to the norm.

At the level of Secretary I note that the actual cost of funding superannuation entitlements does vary, with those longer serving Secretaries participating in the CSS and PSS plans receiving the benefit of higher contributions, the contribution requirements being different from the other plans in which some Secretaries may participate.

I understand that in respect of the Commonwealth Superannuation Scheme (CSS) the Government's contribution in meeting its obligations under the defined benefit element of the fund exceeds 20 per cent (in Mercer's 2010 APS SES Remuneration Survey<sup>13</sup> they indicated that while the CSS is closed to new members, employer contributions averaged 21.4 per cent - including the productivity component of nearly 3 per cent). In relation to the Public Sector Superannuation Scheme (PSSS), which is also closed to new members, the Government's current contribution is set at 16.2 per cent (including the productivity component), whereas in respect of the Public Sector Superannuation Accumulation Plan (PSSAP) the Government's contribution is set at 15.4 per cent. It is my judgement that as part of any change to a Secretary's total fixed remuneration, the actual or actuarial cost of the Secretary's participation should be met within the total fixed remuneration amount.

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<sup>13</sup> 2010 APS SES Remuneration Survey prepared for the Australian Public Service Commission, August 2011.

For illustrative purposes and having regard to prevailing fixed remuneration of Secretaries, the table below reveals the basis of the current deductions and the impact of my proposal if it were adopted retrospectively for a Level 2 Secretary (this is not my recommendation).

	Current TFR \$	Adjusted TFR <sup>1</sup> \$	Actual Nominal TFR <sup>2</sup> \$
Total fixed remuneration (TFR)	504,810	504,810	529,042
Superannuation salary (80 per cent)	403,848	403,848	403,848
Available base salary (BS) *	403,848	379,616	403,848
TFR – BS	100,962	125,194	125,962
Superannuation contribution	**62,192	***86,424	86,424
Deemed value of other non-cash benefits (TFR-BS-VSS)	38,770	****38,770	38,770

<sup>1</sup> The adjusted TFR reflects a reduction in the Secretary's base salary to accommodate the higher contribution to the CSS superannuation plan.

<sup>2</sup> Actual nominal TFR reflects the actual total fixed remuneration cost on the basis of the superannuation contribution being in excess of the deemed contribution rate of 15.4 per cent. It reflects retention of a salary of \$403,848.

\* Adjusted for superannuation contribution and non-cash benefits.

\*\* 15.4 per cent of superannuation salary.

\*\*\* Assumes a 21.4 per cent contribution arising from membership of the CSS fund.

\*\*\*\* Under the adjusted TFR model a Secretary may choose to allocate less funds to their non-cash benefits as their superannuation contribution is fully costed within their total fixed remuneration.

### 3.2.7 Standardisation of non-cash benefits

The principal comment in relation to non-cash benefits made by Secretaries related to the variable cost of parking and the high cost of the provision of a Government vehicle. There were other comments, primarily made by Secretaries whose principal domicile was not Canberra, in relation to the settlement of relocation costs and access to return travel to their principal residence if it were not Canberra. The principal observation was differential treatment of other senior members of the APS, including Ministerial staff.

### 3.2.8 Vehicles and Parking

In relation to vehicles and parking it would be my recommendation that other than in circumstances where the Secretary elects to provide their own vehicle that there be a fixed allocation irrespective of location for the provision of on-site parking for a Secretary and a fixed cost of the provision of a fully maintained Government vehicle.

Having regard to other public sector practices it would be my assessment that the provision of a vehicle and parking should be established in the range of \$20,000 to \$25,000 per annum and, where a Secretary has the benefit of a Government vehicle and parking, that amount should be an automatic deduction from their total fixed remuneration. Where a Secretary provides their own vehicle and parking is provided it would be my recommendation that a fixed amount should be established irrespective of the working location of the Secretary. In my judgement that amount should be established in the range of \$2,000 to \$3,000 per annum. That is, if the Government does not believe there should be differential treatment of Secretaries in relation to their funding of the provision of a vehicle or parking which presently requires different levels of contribution from their total fixed remuneration a fixed amount should be established across the cohort of Secretaries.

While I believe that a fixed cost for the provision of a Government vehicle is appropriate given the hours that Secretaries work and the commitment which they are required to make to the Government and their Minister or Ministers in particular, I would equally regard the provision of parking as a necessary facility to be provided for a Secretary for their security and its cost not be incorporated in their total fixed remuneration arrangements.

In reaching the remuneration cost recommendation in respect of vehicles and parking I was mindful of the Mercer survey referred to above, where in respect of vehicle costs across the SES bands on average the range was from \$25,803 to \$27,295 and for parking the cost distribution ranged from \$2,327 to \$3,126, with the median values ranging from \$1,751 to \$2,983.

In respect of other non-cash benefits, in my judgment they should be costed with the incorporation of direct costs, together with any fringe benefits tax applying. While I acknowledge that the actual cost of providing a vehicle and parking may exceed the nominal fixed deduction from the Secretary's non-cash benefits budget, I believe in all instances the amount deducted should be equivalent, assuming an equivalence of vehicle. In the private sector a number of Chief Executives would drive vehicles with a capital cost well in excess of \$100,000. The actual cost of these vehicles plus the fringe benefits tax would be appropriately incorporated in their total fixed remuneration. Given the significant variability in the private sector I believe that the prevailing arrangements are relevant to that sector, though the more formal and fixed arrangements where vehicle availability is more limited when provided by the Government, the above proposal retains relevance and provides an equitable treatment of Secretaries in regard to their access to a Government provided vehicle.

### **3.2.9 Termination and separation**

Many Secretaries reflected negatively on the termination provisions which applied to Secretaries. It was acknowledged that in the past the changed termination provisions led to an adjustment to a Secretary's total remuneration. Notwithstanding this, my research indicates that pay levels do not in any way reflect excess, and that termination provisions by market standards appear frugal, particularly given the expectation that Secretaries will firmly embrace the APS values and always offer their Ministers fearless and independent advice, albeit that such advice will not always be well received. This employment context appears fundamental in retaining an independent public service and fundamental in ensuring a Secretary's integrity in fulfilling their obligations having regard to the Acts of Parliament to which they are subject in employment.

While it might be argued that a Secretary's being prepared to accept short notice will be influenced by benefits available to them under their superannuation plan, it is not reasonable for termination provisions to remain harsh by community standards given their level of accountability and vulnerability. It would not be common in the marketplace that termination provisions are aligned to a Chief Executive's age and it might be suggested that this is a form of age discrimination. Termination provisions are occasionally aligned to a contract term but there is also provision in most contracts at the level of seniority of a Secretary that the Chief Executive would be given advice six months prior to the end of a fixed term as to the continuity of their appointment.

Few Secretaries indicated that the Government managed this aspect of their employment relationship well. As a consequence, while not a prime driver in their engagement in meeting their position's accountabilities, it was for a number, particularly those not able to benefit significantly under existing superannuation plans, a source of disquiet.

In my judgement there are a number of ways in which this limitation could be addressed. One would be to provide a universal termination benefit irrespective of the timing or circumstances of a Secretary's loss of office other than for cause, resignation or retirement. Another might be aligned to a Secretary's age and benefits available to them arising from their participation in a Government sponsored superannuation plan. Another might relate to the length of a Secretary's tenure at the level of Secretary or, if none of the above attributes would lead to a beneficial outcome, during the first contract period of a Secretary a termination payment could be established at a minimum period, say six months, and capped at a maximum, including notice, at say twelve months.

Further complexities will also arise, including for example in circumstances where a Secretary is reappointed at 55 years or older with long service, where the termination benefit might be set at a maximum of six months, including a period of notice. It is my experience and judgement that the termination payment should include a notice period, though the notice period required of a Secretary should not exceed six months should the Secretary choose to resign or retire. The notice period could be negotiated with the Government on the basis of a mutually agreed time, with no further obligations of payment on the Government or further obligations to serve by the Secretary.

In researching Australia's top 100 listed public companies the dominant notice period or termination benefit was twelve months. A small number had legacy arrangements where notice or termination benefits exceeded twelve months, 15 per cent had a six months' notice period and less than 10 per cent had three months or less. Termination arrangements disclosed in Annual Reports revealed a proportion of organisations provided their Chief Executive Officer with a period of notice and a termination benefit. In some agreements, where the CEO was terminated other than for cause, notice was in addition to the termination benefit, in others notice, if not served, was incorporated in the termination benefit. In around 20 per cent of companies CEOs were required to give twelve months' notice, with around 40 per cent required to give six months' notice and the balance less notice.

Payment on termination also varied, though predominantly included total fixed remuneration plus statutory payments. There were, however, a number of companies with provisions to pay a termination benefit including a pro rata incentive payment or an incentive payment for the period of notice equivalent to the prior year's incentive payment. In a majority of termination arrangements entitlements under long term equity based incentives were catered for under share, rights and option plan rules. As a result the termination arrangements were in the majority of instances equivalent to a minimum of twelve months' total fixed remuneration and in a minority of legacy arrangements well in excess of that amount arising from either the payment of a pro rata annual incentive based on prior performance outcomes with either pro rata entitlement to unvested equity or future entitlement to unvested equity subject to performance conditions being met.

Other provisions which may be relevant in the case of Secretaries would be restraint of employment, in which case there should be additional consideration offered by the Government in relation to the Secretary assuming another office in the service of the Commonwealth Government or a State Government, or indeed the private sector.

### **3.3 Transitioning from current practice**

In my judgement there would be a number of issues that require careful consideration before any significant change in pay levels of Secretaries.

### 3.3.1 Total Employment Cost

The first is that a total employment cost construct needs to be embraced and Secretaries advised of the implications on the basis of their current superannuation provisions, as well as prevailing costing in respect of the provision of a vehicle and parking or allowances provided in lieu.

### 3.3.2 Superannuation

Recently appointed executives to the position of Secretary or those being attracted from outside the Commonwealth Public Service may be disadvantaged in respect of their retirement planning arising from recent superannuation legislation, where there are limits or caps based on allowable contributions. For those under 50 years of age for the 2011/2012 financial year the limit is \$25,000 and for those over 50 years of age for the 2011/2012 financial year the limit is \$50,000. The maximum concessional contribution foreshadowed in legislation (independent of age) is \$25,000. These amounts are independent of non-concessional contributions, which are also subject to prescribed limits.

Given the minimum contribution under superannuation plans to which Secretaries presently contribute, for those who are required to join a new fund where their contribution exceeds \$25,000 in future years will face a premium (penalty) tax of an additional 31.5 per cent which could either be paid by the individual taxpayer (Secretary) out of their net income or be deducted from the funds contributed where the contribution exceeds the cap applied under legislation. This circumstance is no different from senior executives changing positions in the private sector, though will bring about a circumstance of progressively unequal benefit among shorter serving Secretaries and/or those whose service with the Commonwealth has not been a lengthy one.

The excess contributions tax would be imposed on the Secretary, not the superannuation fund, although the tax can be deducted from the individual Secretary's superannuation fund account. The current rate of penalty tax is 31.5 per cent and is payable in addition to the 15 per cent tax which applies to superannuation plan contributions. On the basis of a standard 15.4 per cent contribution having regard to the current TFR of a Level 2 Secretary, from July 2012 of the \$62,192 contribution to an accumulation fund \$25,000 would represent a concessional contribution and \$37,192 would be taxed at 46.5 per cent, the 15 per cent concessional tax rate plus the penalty tax rate, or an additional tax of \$17,294.

With an objective to partially align Secretaries' fixed remuneration to a second quartile rate of reward in the private sector the Tribunal should also give consideration in this context to progressively reducing the proportion of a Secretary's remuneration which would act as the superannuation base for retirement benefit purposes. I note since 1999 the superannuable proportion of a Secretary's fixed remuneration has varied from 70 per cent to 80 per cent. My observations are that the private sector would typically adopt a lower proportion of total fixed remuneration for the purposes of establishing a superannuable salary.

On the basis of my long experience I believe it would be closer to 70 per cent than to 80 per cent, though equally observe that a number of highly paid senior executives who are providing a capital base for their future through participation in equity based long term incentive plans are only contributing the maximum required under the superannuation guarantee legislation, which at the time of conducting my research is based on a superannuable salary of \$175,280 or a contribution of \$15,775.20 per annum.

In transitioning reward for Secretaries I believe there would be merit in reducing the superannuable component of their total reward in three stages, achieving a 70 per cent rate of contribution from 1 July 2013, commencing at 75 per cent with the foreshadowed TFR

uplift in December 2011, reducing to 72.5 per cent with effect from 1 July 2012 and 70 per cent with effect from 1 July 2013.

### 3.3.3 Contractual Amendments

It would further be my judgement that new contracts of employment should be established reflecting the changes and the basis upon which future adjustments to a Secretary's pay level would be made, the frequency of those adjustments or the Government policy in relation to those adjustments, as well as linking of changes to the classification of the position held by a Secretary, including as a result of Government restructure a Secretary's position being classified at a lower level than the one which they occupy at the time that the proposed changes were introduced.

The contract should also provide appropriate provisions for a Secretary occupying a role at a lower classification level being given a minimum of two years to transition to the pay band appropriate to their new role, with no decrease in their remuneration, though future increases to be absorbed until the Secretary's payment level is equivalent to the midpoint of the pay band in the classification of their new position.

### 3.4 Recommended remuneration levels

Having regard to the diversity of market inputs, though primarily using total fixed remuneration applying in the private sector, a construct of reward is capable of being established. I believe that certain principles should be adopted in the management of a transition to a new TFR structure, including:

- An agreed benchmark of comparators should be adopted and recommended by the Remuneration Tribunal.
- The Government should endeavour by the end of calendar year 2012 to have positioned Secretaries' TFR reference rate at a level equivalent to an agreed benchmark, for example the 25<sup>th</sup> percentile of an agreed market.
- TFR arrangements agreed to should incorporate the total remuneration cost of a Secretary's employment, though exclude certain agreed conditions associated with their employment.
- Secretaries should not be entitled to performance pay.
- Termination provisions should be reasonable by market standards in order to provide Government, on the recommendation of the Secretary of the Department of the Prime Minister and Cabinet, with the facility to terminate Secretaries for convenience on behalf of the Government of the day.
- The minimum termination benefit, including period of notice, should be set at six months' TFR.
- For Secretaries terminated under 55 years of age with five or more years' service as a Secretary the minimum termination benefit should be established at twelve months' TFR.
- For Secretaries who are members of the CSS and PSS superannuation plans and are terminated after 55 years of age their termination and notice period should be capped at six months.

- For Secretaries who are not members of the CSS or PSS retirement plans they should receive a minimum notice period of six months and a termination payment of six months' TFR.

Differences in termination payments on the basis of age may have to be progressively adjusted in line with changes in recognised retirement ages and market practice while also conforming with the law and APS policy and practices.

The following sets out a market based reward structure for Secretaries having regard to the relevant recommended cohorts for benchmarking purposes.

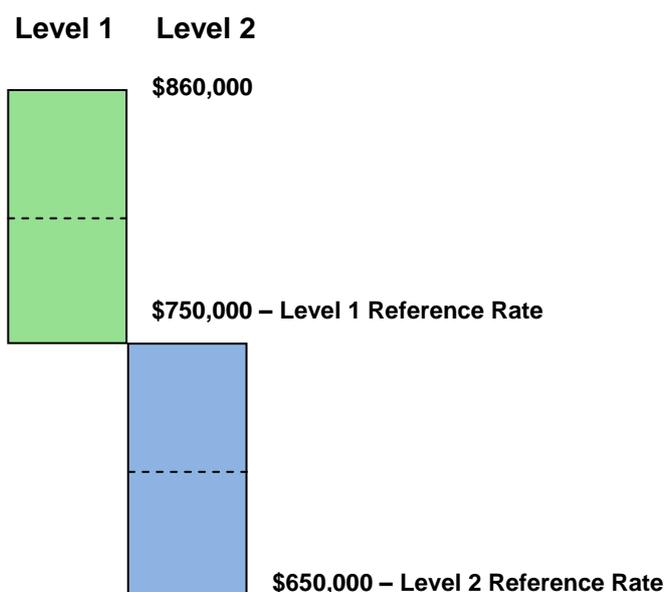
### 3.5 Recommended pay structure

#### 3.5.1 Overlapping bands/discrete pay bands

There is merit in both approaches. My preference is for discrete pay bands. It is my recommendation that an indicative maximum of each pay band would be set in the range of 15 per cent to 20 per cent of the reference rate. The reference rate for Level 1 would be equivalent to the maximum of a Level 2 position. I would recommend that the reference rate be reviewed on an annual basis.

Should the overlapping model be embraced I would be inclined to recommend that the range from the reference rate to the maximum be increased above 15 per cent and that the overlap be a maximum of 5 per cent.

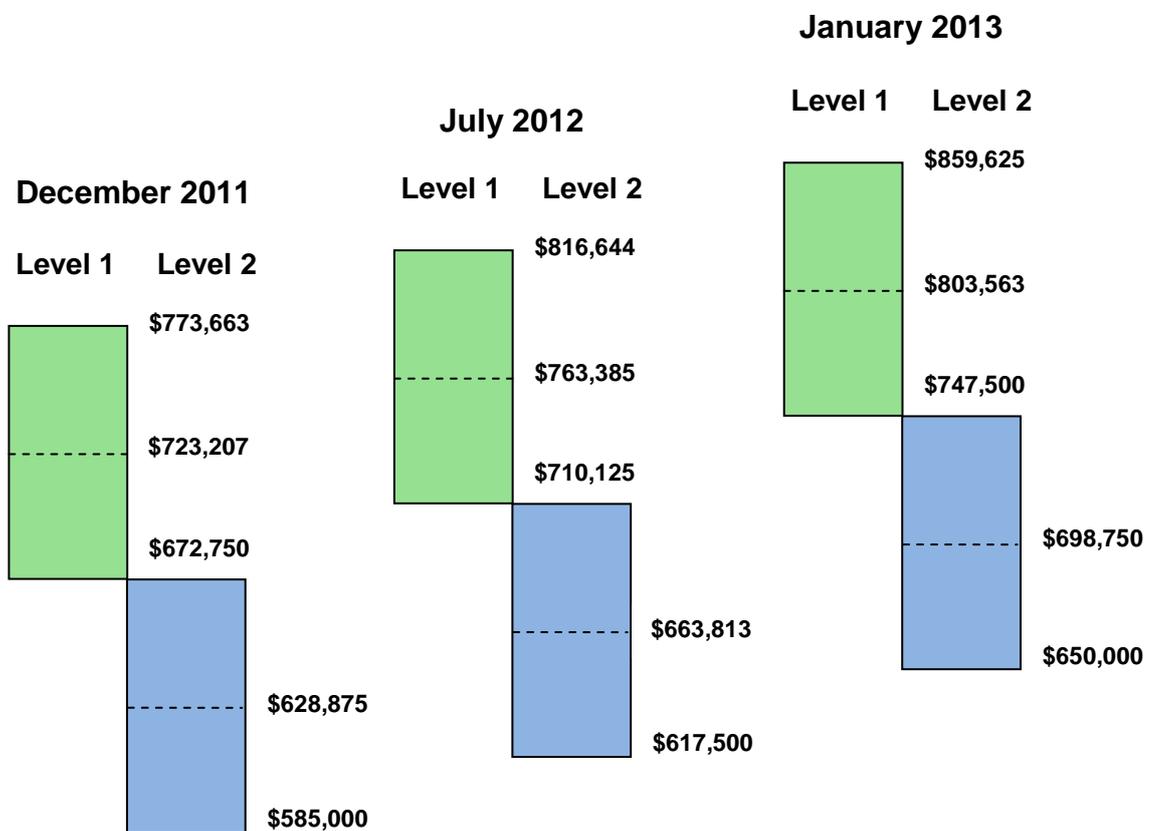
Given my preference is for discrete non-overlapping pay bands, but a conjoint between the maximum of Level 2 and the minimum of Level 1 (the reference rate) pay levels for Secretaries, the following illustrates a work toward pay structure through to the commencement of the 2014 financial year. Notwithstanding the above proposal which reflects some sensitivity to public sector pay practice and adopts a defined structure in a pay relativity construct, the following chart sets out a private sector market based reference rate TFR for each Secretary classification level rounded for illustrative purposes.



### 3.5.2 Transition approach

On the basis of the gap between present levels of TFR and the market reference rate it is my proposal that a reward structure be developed to meet a market competitive rate over the next fifteen to eighteen months in three separate adjustments, the first with immediate effect, the second from 1 July 2012 and the third from 1 January 2013. In preparing the above indicative range recommendation I have assumed that the reference rates would need to be adjusted to reflect an indicative 25<sup>th</sup> percentile of relevant markets by the beginning of the 2013 calendar year. The model below reflects a progressive uplift in Secretaries' TFR in an endeavour to ensure that pay rates approach the private sector 25<sup>th</sup> percentile level of total fixed remuneration. It will be noted that the initial positioning of the reference rate is below the benchmark and the maximum will be similarly positioned without the reference rates being adjusted on an annual basis, either by calendar year or financial year.

Illustration of a time series transition pay model



The starting point for adjustment has been established at 90 per cent of the Level 2 reference rate which it is proposed will take effect from the beginning of the 2013 calendar year. The position in July 2012 represents a point 95 per cent of the reference rate. The adjustment from current TFR rates for a Level 2 Secretary is 15.9 per cent and for a Level 1 Secretary 24.68 per cent. The above strategy reflects an expanded separation in relativities between Level 1 and Level 2 Secretaries which has been preserved over the past decade at around 93 per cent. The above recommendation positions a Level 2 Secretary's reference rate at 85 per cent of a Level 1 Secretary's reference rate.

While it is acknowledged that all Secretaries fulfil an important role in the stewardship of the administration and policy initiatives of the Australian Government, my recommendation (excluding the position of Secretary of the Prime Minister and Cabinet and Secretary of the Treasury) acknowledges a substantial differential in the average revenues, direct expenditures and appropriations of the two levels of Department under the stewardship of Secretaries. The former having oversight of indicative appropriations in the order of \$36 billion and the latter \$3.25 billion. The former have stewardship of revenue in the order of \$3 billion and expenditures in excess of \$3 billion compared to the latter of around \$350 million in both instances.

I believe that the traditional separation does not adequately reflect the differential in the scale of programs under the stewardship of Secretaries classified at Level 1 and Level 2, nor the variability in the breadth of programs and Agencies under the respective Secretaries' direction.

My judgement has also been significantly influenced by the change in the relative ranking of a number of Departments. When the initial relationship was established Level 1 Secretary positions consisted of the Prime Minister and Cabinet, Treasury and Defence. Following the work which I undertook in 2008/9, there are now nine Departments classified in Level 1 which substantially changes the balance and indicative fiscal accountability of Department Secretary roles which continue to be classified at Level 2. These variable dimensions are set out in Appendix A.

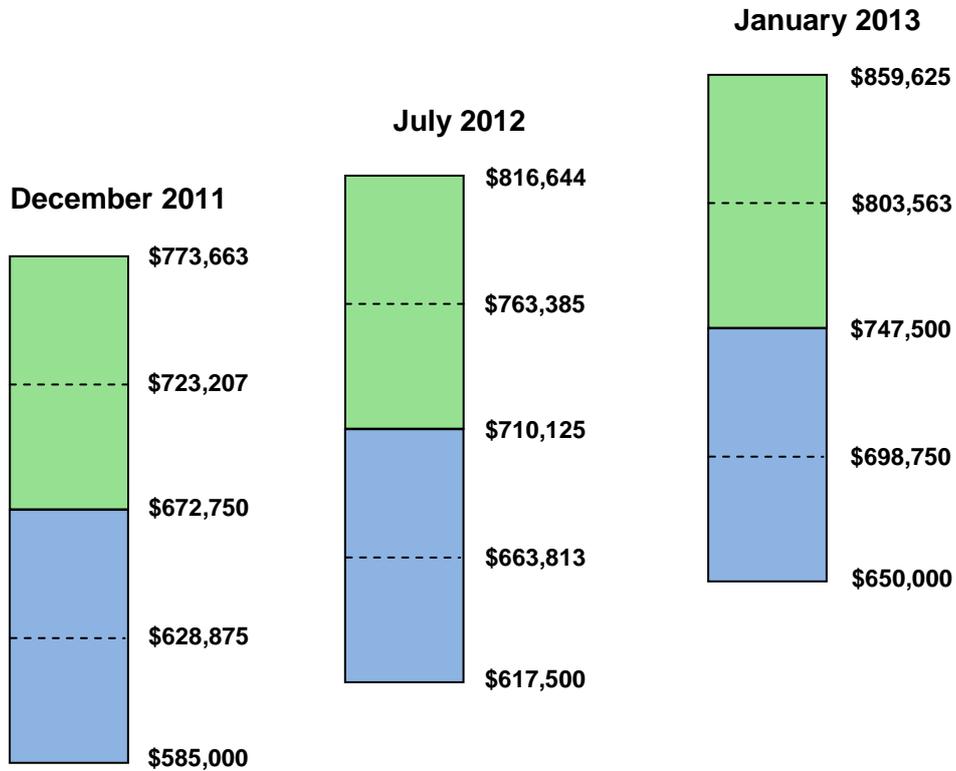
### **3.5.3 Transitioning within a Public Sector Environment**

Given that over the past ten years the gap between the most highly paid Secretary and the least well paid Secretary has ranged from \$18,000 to \$31,480 and given the market based differentials observed in the data above, I have developed an accommodating structure which is less expansive than that reflected in private sector reward practices.

In essence the pay structure proposed for the two classification levels has five discrete payment steps to reflect payment at the time of appointment, payment on reappointment and payment reflecting long service and acknowledged exemplary performance and significant contribution to the administration of Government. I acknowledge under the new legislative framework that the actual payment of Department Secretaries, other than those with accountability for the Departments of the Prime Minister and Cabinet and Treasury, will be determined by a committee chaired by the Secretary of the Department of the Prime Minister and Cabinet, with the President of the Remuneration Tribunal and the Public Service Commissioner.

This report does not contain guidelines to direct that decision process, though I am aware that the Commonwealth have comprehensive guidelines in relation to pay determinations having regard to the criteria nominated above. The reference rate for Level 1 Secretary positions is comparable to the maximum payment available to a Secretary in a position classified as Level 2, excepting in circumstances where a long experienced Secretary in a Level 1 Department is appointed to lead a Department classified in Level 2.

**Transition steps: 2011 - 2013 TFR adjustment**



Should a single payment for each classification level reflecting current practice be a preferred approach by the Tribunal and/or the Australian Government the appropriate TFR levels are set out in the table below.

Classification Level	December 2011 \$	July 2012 \$	January 2013 \$
1	723,207	763,385	803,563
2	628,875	663,813	698,750

Given that in my earlier work I formed the view in work value terms that the positions of Secretary of the Department of the Prime Minister and Cabinet and Secretary of Treasury were the most onerous and influential positions in Level 1 and given that the determination of their TFR rests with the Remuneration Tribunal, it would be my judgement that an appropriate remuneration arrangement could be set within a range from the reference rate of Level 1 to a premium of 20 per cent.

In respect of the award maximum in December 2011, the range within which these positions' total fixed remuneration could be determined would be \$672,750 to \$807,300, in respect of July 2012 the range would be from \$710,125 to \$852,150 and in respect of January 2013 the range would be from \$747,500 to \$897,000.

### 3.5.4 Transition Superannuation Salary

In light of my recommendation to reduce the superannuable salary from the current 80 per cent of TFR to 70 per cent by July 2013, the table below highlights the Reference Rate superannuable salary for Secretaries at Level 1 and Level 2 should my recommendation be adopted.

<b>Superannuable Salary</b>	<b>August 2011</b> \$	<b>December 2011</b> \$	<b>July 2012</b> \$	<b>July 2013</b> \$
Level 1 Reference Rate	431,664	504,563	514,841	523,250
Level 2 Reference Rate	403,848	438,750	447,687	471,250

## 4. Appendices

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## Appendix A Classification Levels

	Classification Level		No. of Ministers/ Parliamentary Secretaries	FMA Act Agencies/ Statutory Bodies	Staff	Budget
	1	2				
<b>Agriculture, Fisheries and Forestry</b>		■	1 / 1	3	4,598	Appropriations \$1.362 billion Expenditure \$664 million Staff costs \$437 million Revenue \$669 million
<b>Attorney General</b>		■	2 / -	19	1,474	Appropriations \$887 million Expenditure \$266 million Staff costs \$165 million Revenue \$248 million
<b>Broadband Communications and the Digital Economy</b>		■	1 / -	1	692	Appropriations \$3.297 billion Expenditure \$126 million Staff costs \$75 million Revenue \$125 million
<b>Climate Change and Energy Efficiency</b>		■	1 / 1	1	821	Appropriations \$554 million Expenditure \$186 million Staff costs \$102 million Revenue \$231 million
<b>Defence</b>	■		3 / 1	1	80,937(E*)	Appropriations \$42.406 billion Expenditure \$23.863 billion Staff costs \$10.069 billion Revenue \$22.440 billion
<b>Education, Employment and Workplace Relations</b>	■		4 / 1	7	5,471	Appropriations \$43.384 billion Expenditure \$922 million Staff costs \$523 million Revenue \$784 million
<b>Families, Housing, Community Services and Indigenous Affairs</b>	■		3 / 2	1	3,232	Appropriations \$79.292 billion Expenditure \$616 million Staff costs \$354 million Revenue \$549 million
<b>Finance and Deregulation</b>	■		3 / -	4	1,946	Appropriations \$14.919 billion Expenditure \$588 million Staff costs \$170 million Revenue \$568 million
<b>Foreign Affairs and Trade</b>	■		2 / 2	4	3,971	Appropriations \$2.131 billion Expenditure \$996 million Staff costs \$412 million Revenue \$1.023 billion
<b>Health and Ageing</b>	■		3 / 1	9	5,421	Appropriations \$48.457 billion Expenditure \$762 million Staff costs \$527 million Revenue \$745 million
<b>Human Services</b>	■		1 / -	N/A	4,565	Appropriations \$6.520 billion Expenditure \$815 million Staff costs \$519 million Revenue \$706 million
<b>Immigration and Citizenship</b>		■	1 / 1	1	8,879	Appropriations \$3.022 billion Expenditure \$1.295 billion Staff costs \$680 million Revenue \$1.229 billion

	Classification Level		No. of Ministers/ Parliamentary Secretaries	FMA Act Agencies/ Statutory Bodies	Staff	Budget
	1	2				
<b>Infrastructure and Transport</b>		■	1 / 1	1	981	Appropriations \$3.998 billion Expenditure \$216 million Staff costs \$104 million Revenue \$205 million
<b>Innovation, Industry, Science and Research</b>		■	2 / -	2	2,455	Appropriations \$4.029 billion Expenditure \$146 million Staff costs \$95 million Revenue \$146 million
<b>The Prime Minister and Cabinet</b>	■		8 / -	10	980	Appropriations \$548 million Expenditure \$230 million Staff costs \$111 million Revenue \$214 million
<b>Regional Australia, Regional Development and Local Government</b>		■	1 / -	1	335	Appropriations \$2.129 billion Expenditure \$68 million Staff costs \$46 million Revenue \$67 million
<b>Resources, Energy and Tourism</b>		■	2 / -	2	502	Appropriations \$912 million Expenditure \$101 million Staff costs \$51 million Revenue \$100 million
<b>Sustainability, Environment, Water, Population and Communities</b>		■	1/1	4	2,740	Appropriations \$3.318 billion Expenditure \$540 million Staff costs \$248 million Revenue \$477 million
<b>The Treasury</b>	■		2/1	14	1,053	Appropriations \$87.323billion Expenditure \$178 million Staff costs \$120 million Revenue \$168 million
<b>Veterans' Affairs</b>		■	1 / -	N/A	2,051	Appropriations \$12.238 million Expenditure \$352 million Staff costs \$183 million Revenue \$324 million

Appropriations – defined as Total Net Resources including special appropriations and accounts, source Budget Portfolio estimates for 2011-12,

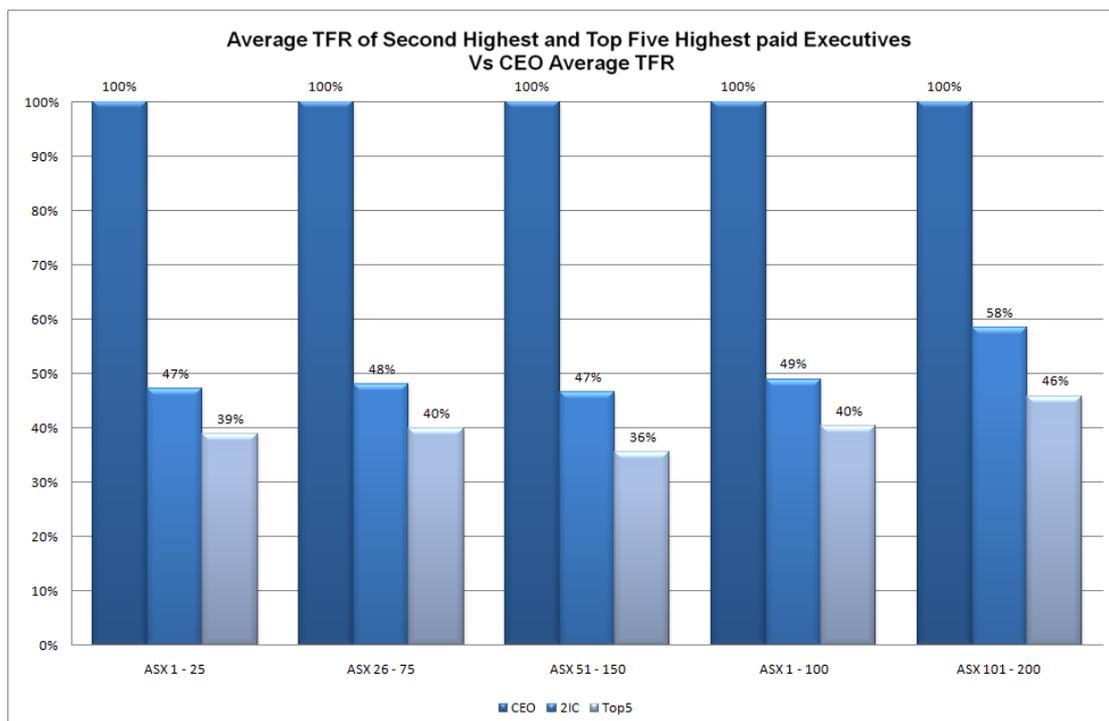
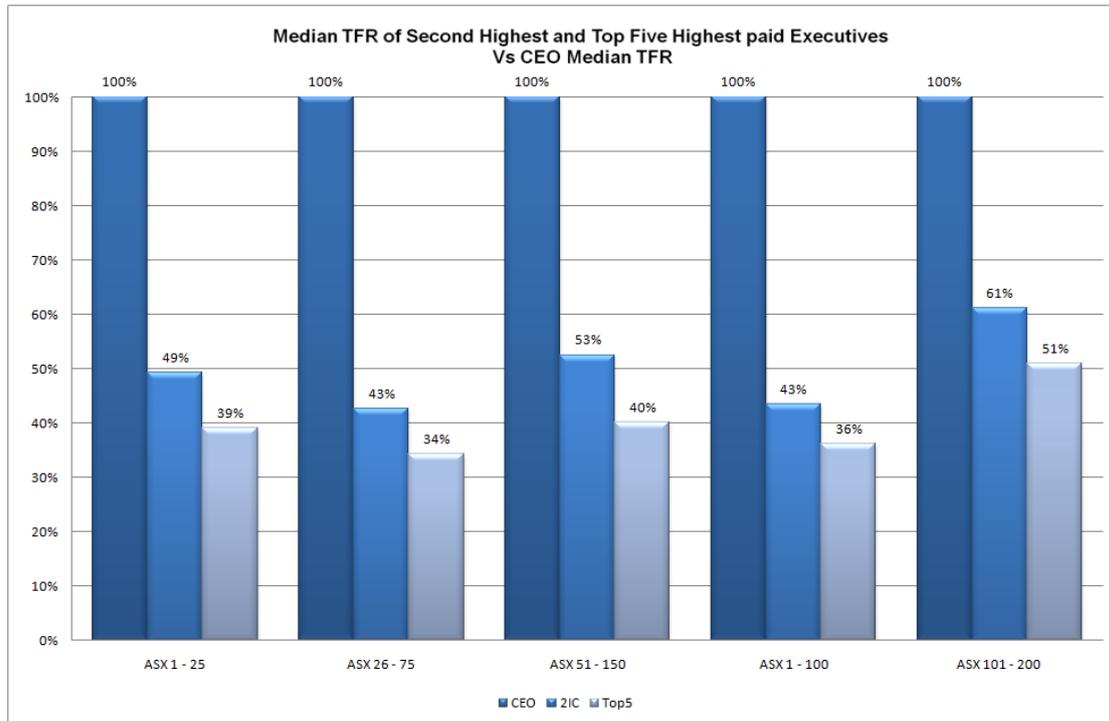
Expenditure, Staff Costs, Revenue and Staff, source 2010- 2011 Annual Report by Department, with exception of the Prime Minister and Cabinet and Regional Australia, Regional Development and Local Government departments source Budget Portfolio estimates for 2011-12.

\*Excludes reservists; aggregate of uniformed staff and APS staff plus reservists approximate 107,000.

## Appendix B

### Pay Relativities

The attached graphics provide details on the relative proportion of total fixed remuneration at the median and on average of the top 5 executives and the second highest paid executive compared to the CEO (100 per cent) in selected ranked companies on the Australian Securities Index. The relativity analysis only relates to total fixed remuneration.



## Appendix C

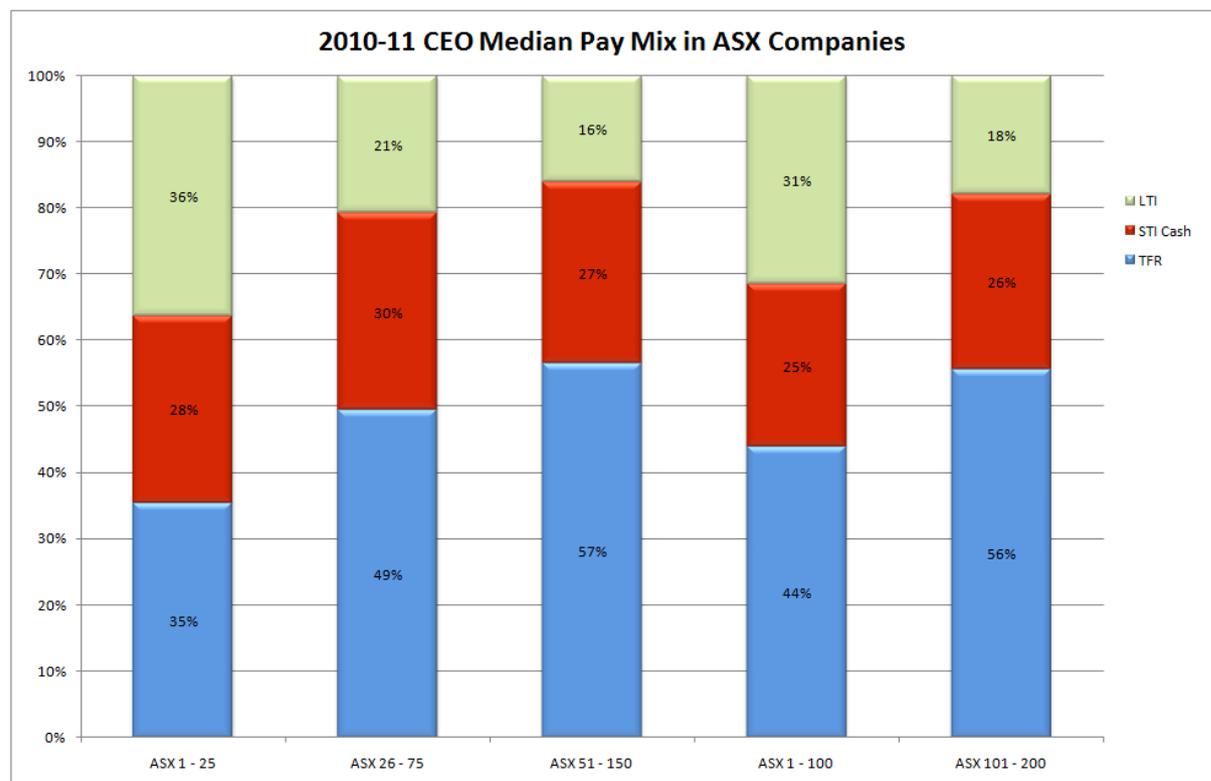
### Total Reward in the Private Sector

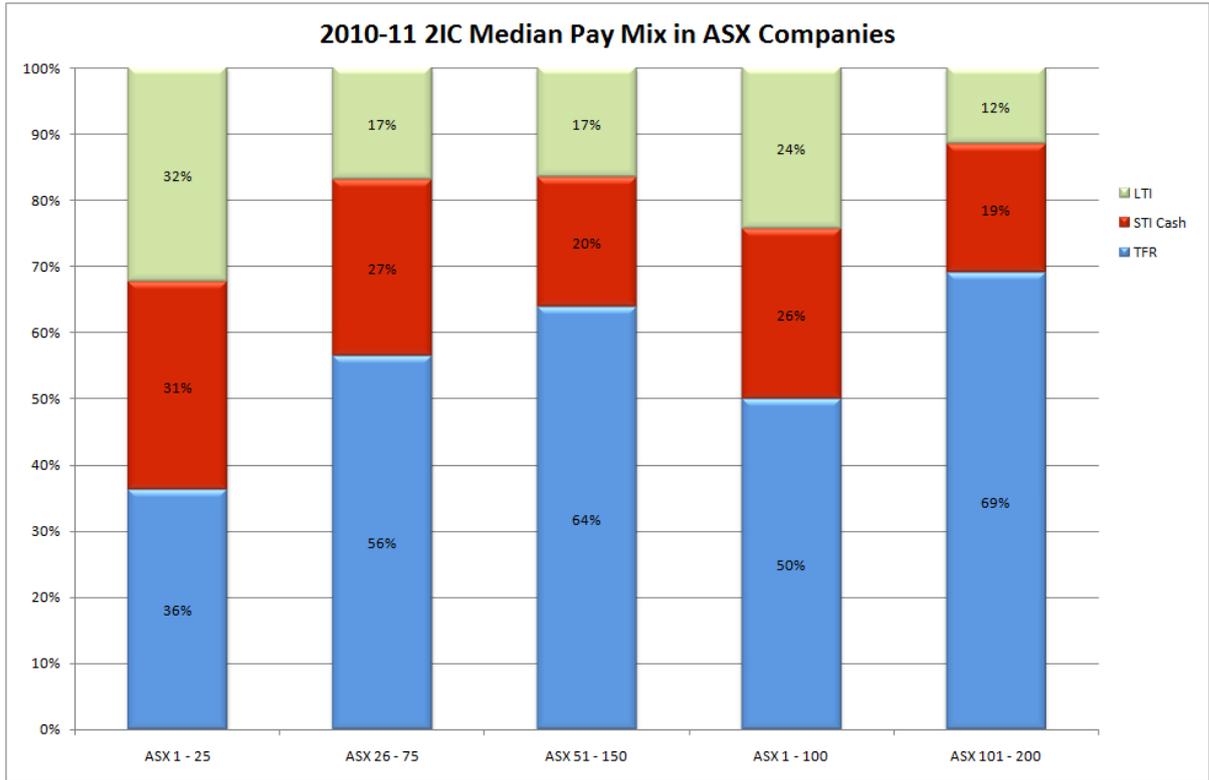
The tables below provide information on the relative proportion of reward components of Chief Executives and the second highest paid executives at the median in nominated ranked groups drawn from those listed on the S&P/ASX.

The first two tables provide information on the total proportion of reward out of 100 per cent attributable to total fixed remuneration, annual bonus (STI cash) and the annualised carried interest in equity based long term incentives. The methodology for the calculation of the long term carried interest is attached. The data has been marked to market at 30 September 2011 and has been risk adjusted on the basis of the probability that only two-thirds of securities allocated to key management personnel will meet performance hurdles and vest.

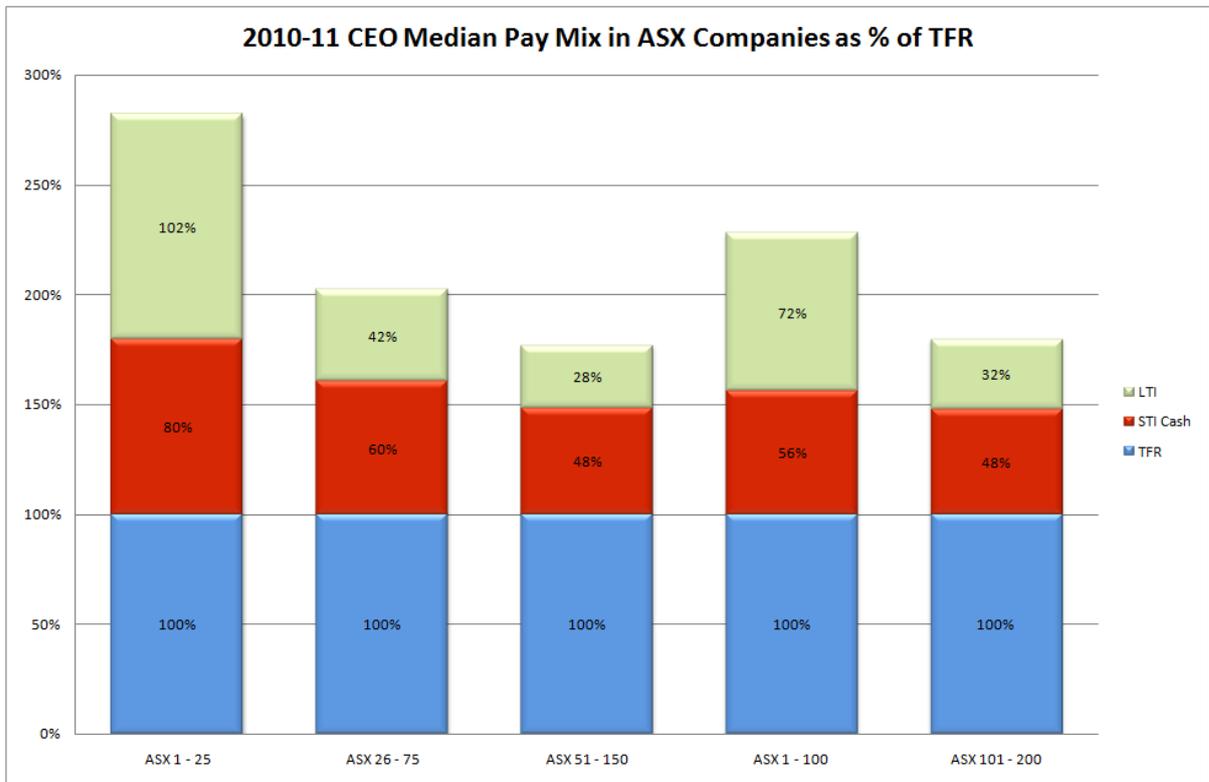
The second series of graphs reveal the ratio between total fixed remuneration and the most recent annual bonus or incentive payment and the executives' annualised carried interest in equity based long term incentives. While there may be variations in the proportions of each component where the second highest paid executive appears to have a higher proportion of carried interest in equity, it will be noted that this interest is based on a significantly lower level of total fixed remuneration.

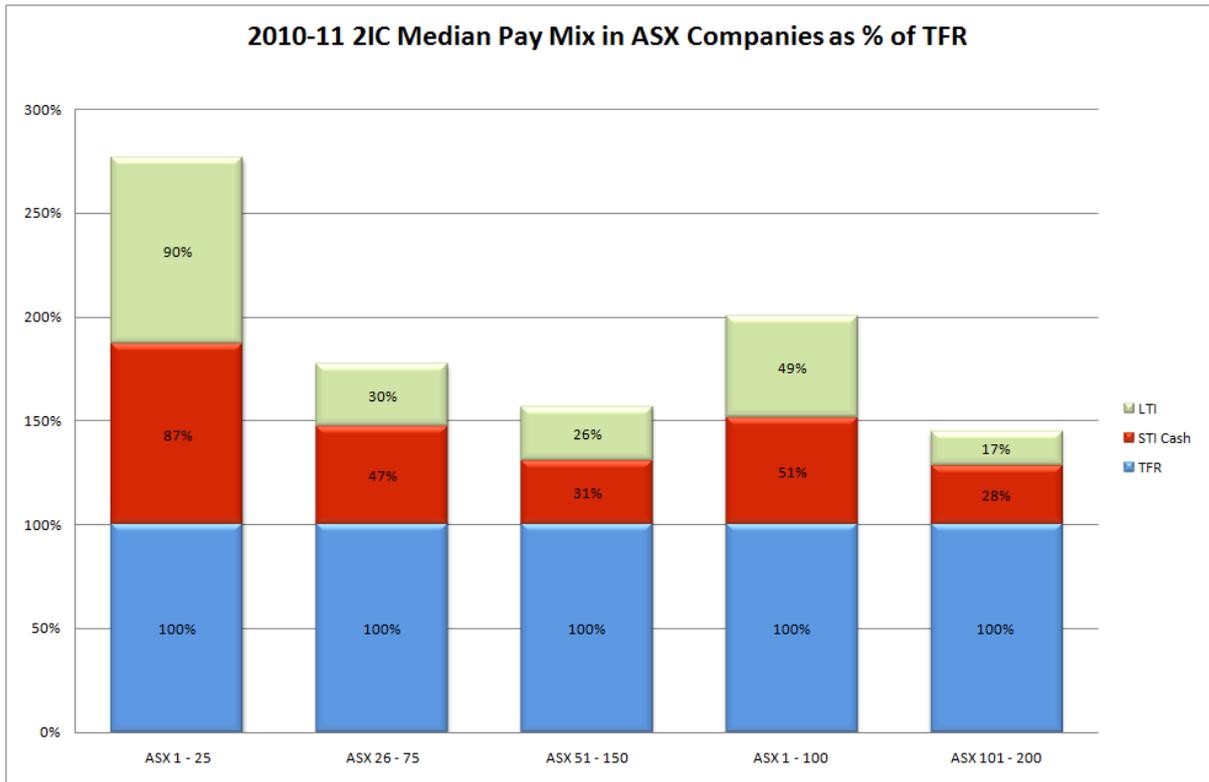
The graphic illustrations detail the total reward arrangements in the marketplace at the end of the 2011 financial year (30 June) and reveal the proportion which TFR represents of an executive's total reward opportunity, including the value of annual incentive payments and equity based long term incentive values. The data also reveals the proportion of these elements of reward having regard to both the CEO' and second highest paid executives' total reward arrangements.



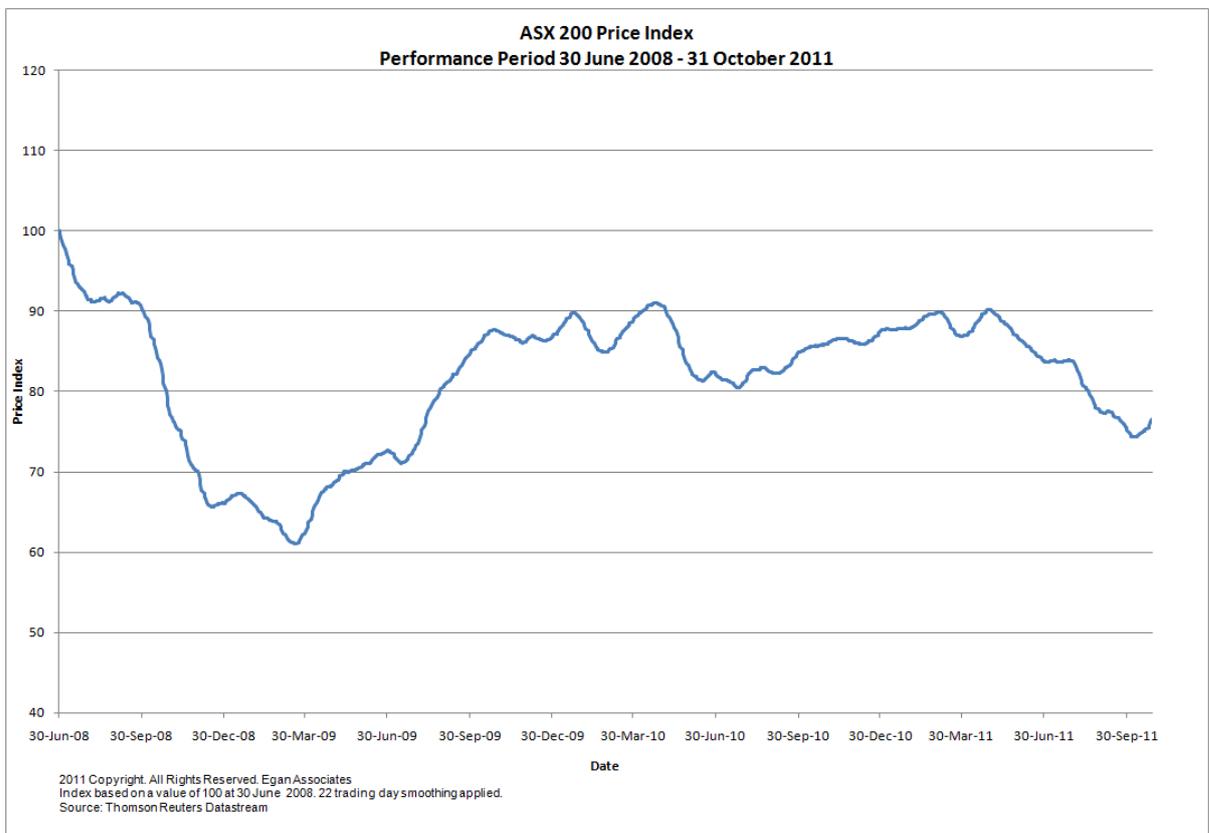


Assuming that TFR equates to 100 per cent, the following two graphs illustrate the relative proportions of annual bonus or incentive arrangements (STI cash) and the annualised value of executives' carried interest in equity based long term incentives.





\* TFR = total fixed remuneration.



## **Methodology for calculating elements of remuneration and definition of those elements**

The following provides definitional information on the terms used in the report and particularly in the comparator analysis. I also provide an explanation of the basis upon which the annualised value of long-term incentive is calculated by Egan Associates.

In relation to some positions from which data has been drawn from the external market, I have not had complete information relating to the history of equity grants prior to the individuals assuming their present roles. I have excluded benefits arising from unlatching arrangements or other contract payments at the time of appointment. Where I know that previous grants made have vested, though not been exercised, I have ignored vested securities in my LTI calculations. Where securities have been capable of vesting, though for reasons of performance have not yet vested, they have been included. In this context I have relied upon our prior years' database and knowledge of each comparator company's performance.

While in the area of LTI calculations I acknowledge that there will be some under and over estimation of equity holdings, of more particular interest is the dramatic decline in the value of equity holdings over the past twelve months, given that all comparative information has been marked to market as at 31 March 2009. While this analysis reveals a nominal incentive value, in a significant proportion of cases long term incentive equity holdings associated with grants in 2006 and 2007 are presently '*under water*'. I have made no attempt to establish value on a marked to market basis (that is the '*in the money*' value from the date of grant). I have, as noted, used a common calculation of value as set out below for all securities granted under LTI programs.

In the current year's review the LTI values are clearly the most problematic given the dramatic downturn on the global bourses over the past twelve months. Notwithstanding, as an increasing proportion of LTI awards have been in the form of share rights or performance shares, if performance hurdles are met, that is, for example, earnings per share or relative total shareholder return, even though present share values represent a decline on the value of the date of the award, a benefit will arise to participating executives under current long term incentive plans.

In order to create a common foundation for the valuing of LTI awards, whether they are options, share rights or performance shares or indeed restricted shares, subject to specific vesting conditions, I have adopted a simple future value methodology in order to create a common remuneration value.

Across our broader sample I have ignored accounting values or other values ascribed to equity grants by all companies from which data has been drawn and applied our analysis protocol to the actual number of awards and the nature of awards without initially applying any adjustment on the basis of the probability of securities granted vesting, given the requirement to meet a predetermined performance hurdle(s). I have risk adjusted LTI values adopting our standard methodology to reflect the probable remuneration outcome, not necessarily the reward intent, underpinning the grant of equity under a performance tensioned incentive award. Our risk adjusted LTI value (two-thirds of the full value) reflects a probable value on the basis of our research over recent years. The following sets out the key definitions of the core components of remuneration.

### **Total Fixed Remuneration (TFR)**

Consisting of Salary, Superannuation, Fringe Benefits Tax and Other Benefits made available to executives.

**Short Term Incentive (STI)** – normally paid in the form of cash, subject to company, business unit and individual performance. In some companies a proportion of the STI is deferred in the form of restricted shares.

**Total Remuneration** – the sum of TFR and STI.

**Long Term Incentive (LTI)** – normally delivered by way of securities, as options, performance shares or share rights, though in some leading companies the LTI is paid in cash, being a derivative of relevant financial metrics.

Egan Associates have expressed the market information on the following basis:

**Annualised Long Term Incentive:** *In order to create a common foundation for the valuing of LTI awards, whether they are options, share rights or performance shares or indeed restricted shares, subject to specific vesting conditions, I have adopted a simple carried interest<sup>14</sup> valuation methodology. In situations such as recent hires without a history of grants the company's target LTI award is used. The carried interest method will use equity grants over the last three years. It is calculated as the annualised capital value plus one year's price growth for the last three years' share grants plus one year's capital gain on the last three years' option grants. The carried interest method of valuation assumes a compound share price growth rate of 10 per cent per annum.*

*The long-term incentive represents the executives "carried interest" in the company, considering shares, options and other equity incentives granted in the past 3 years (or past 5 years if there are no grants within the past 3 years). The annualised value of securities is an estimated value at the current market price assuming that the market price will appreciate at the rate of 10 per cent per annum. Fully paid shares (including performance shares, share rights, performance rights or restricted shares) reflect an annualised capital value assuming that the existing value will appreciate by 10 per cent in the current year.*

*For example, if shares were issued in the past three years and had a combined value of \$300,000, the annualised value would incorporate one third of the then capital value of \$100,000, plus the annual incremental value on the shares, which would be \$30,000, or a total annualised value of \$130,000. In respect to options with a face value of \$300,000 granted in the past three years, the ascribed annualised value would be \$30,000. This represents the assumed increase to the capital value of the equity in the current year.*

*Risk adjusted calculations adopt the above methodology, though assume that one-third of the LTI value will not be realised as a result of performance conditions not being met.*

**Total Reward (TR)** – The sum of TFR, STI and LTI.

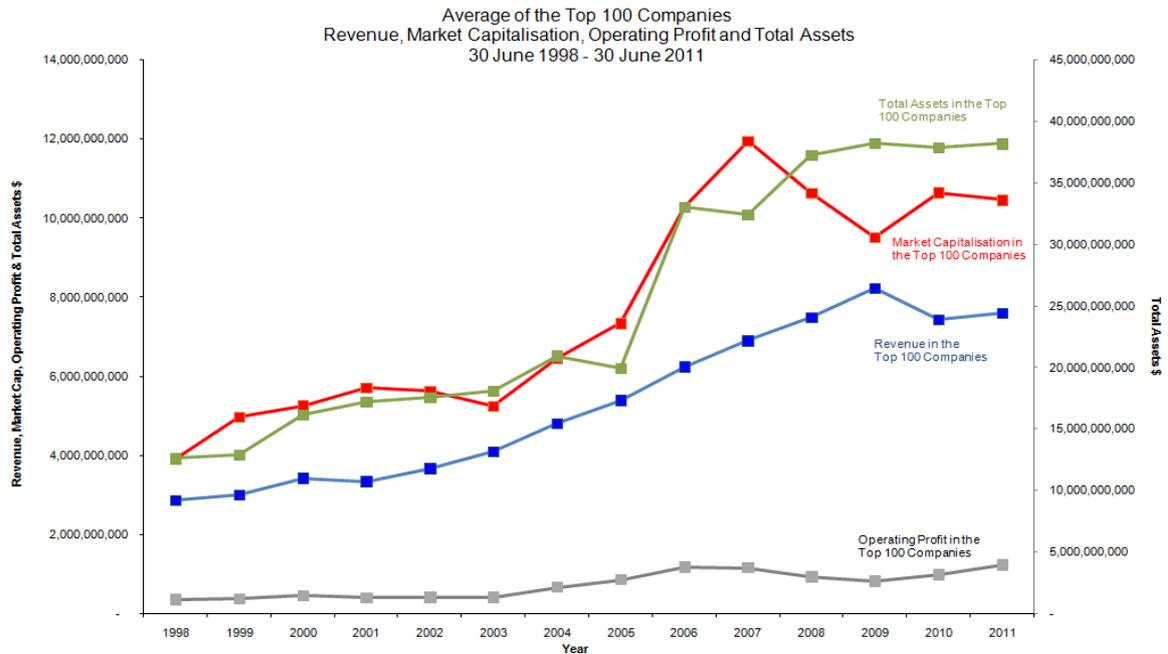
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<sup>14</sup> Carried interest is a concept adopted in a number of investment settings. In respect of employee equity based long term incentive plans the term has been adopted to represent an employee's nominal share of profit arising from their participation in a long term incentive plan. Their carry is represented by the market value of a share or right adjusted for an estimated future profit.

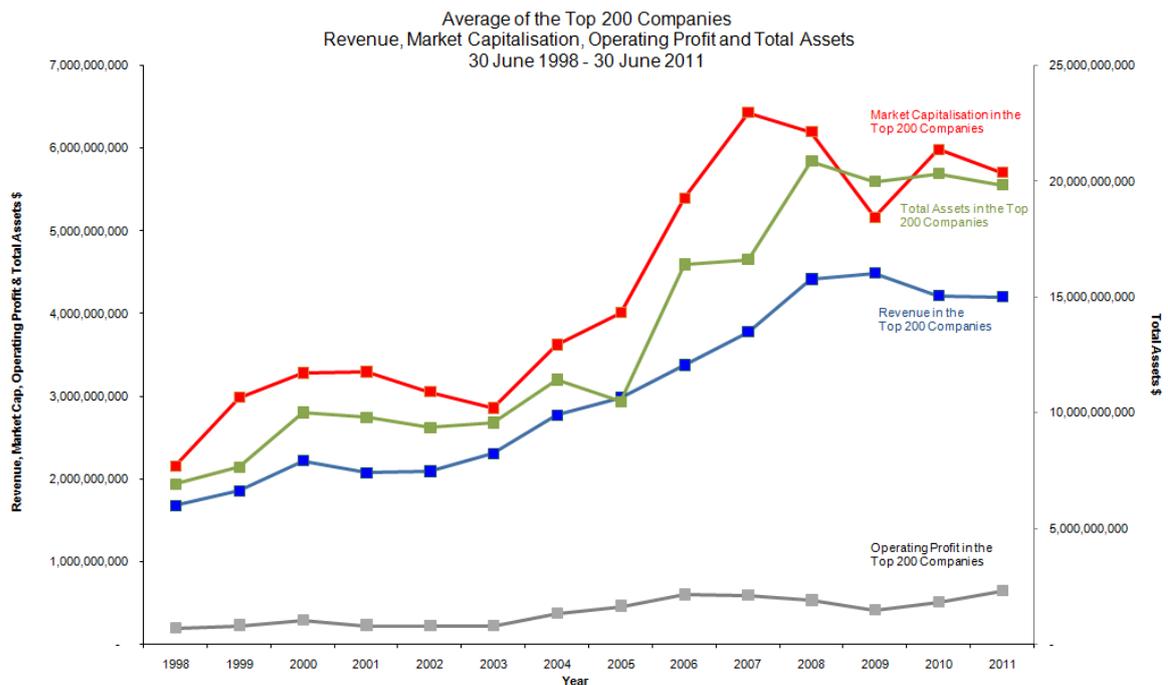
## Appendix D

### Financial metrics 1998 to 2011 – ASX 200

The graphs below reveal both the growth and recent decline in the value of key financial metrics for the S&P/ASX top 200 companies.



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Companies are ranked as at 30 June of each year (and excludes property trusts, funds, overseas entities and subsidiaries).



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