Wednesday, 30 November 2022

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

By email: corporations.joint@aph.gov.au

Dear Committee Secretary

Inquiry into the effectiveness of Australia's corporate insolvency laws

Chartered Accountants Australia and New Zealand (CA ANZ) welcome the opportunity to provide feedback to the inquiry noted above. Our feedback reflects the lived experience of our members who work with businesses facing financial stress and from our members who are registered liquidators (liquidators) and/or trustees in bankruptcy.

Recognising that the majority of corporations in Australia are small businesses, it must also be acknowledged that directors of these small businesses are often required to offer their personal assets as security for their business's commercial dealings. Accordingly, directors of small corporations that become insolvent will find themselves made bankrupt having given a personal guarantee to obtain finance for their business.

Therefore, we seek for this inquiry to be the first step in a holistic review of Australia's insolvency laws, both corporate and personal. Pending such a review, we consider the implementation of the following recommendations in corporate insolvency will have immediate benefit to all persons facing financial stress:

- Raise the statutory demand threshold to $10,000.

  As the inability to meet a statutory demand will place that business into liquidation, the threshold should seek to at least cover the cost for a liquidator to undertake the minimum amount of work demanded by current insolvency laws, which is upwards of $7000.

  A higher threshold will also be of benefit to all creditors. A low threshold too easily enables a single creditor to push a company into liquidation even though the cost to undertake the process may exceed the debt being chased by that creditor.

  In recommending an increase, we also seek a single threshold for creditors to commence recovering debts through insolvency. Accordingly, we recommend the statutory demand threshold under the *Corporations Act 2001* (Cth) (the Act) be $10,000 to align with, and kept in line with, the threshold for a creditors' petition under the *Bankruptcy Act 1966* (Cth).

- Raise the maximum default remuneration for liquidators to $10,000.

  We seek for the current maximum to be adjusted in consideration of the inflationary pressures in the economy and tight labour market.

  The flow on benefit will be a reduction in costs for small-value liquidations as some statutory obligations, such as calling a creditors meeting, are only required where the remuneration of a liquidator will exceed the maximum default remuneration.

  It is important to note that the maximum is not automatically drawn, only actual remuneration incurred, up to the maximum, can be drawn.

- Amend the eligibility to appoint a restructuring practitioner to a company to require employee entitlements to be substantially up-to-date providing the restructuring plan first satisfies outstanding entitlements.

  The last statistics published by ASIC that detail data on external administration are for the financial year 2018-19. These statistics indicated that of the approximately 5600 businesses with liabilities of less than $1 million, just over 2800 had superannuation owing of less than $100,000. From our member's experience, this unpaid superannuation is often historical with current entitlements up to date.

  By easing the requirement for employee entitlements to be fully paid prior to appointment, with the caveat that any outstanding amounts are paid first in a restructuring plan, many additional viable small businesses will be able to consider restructuring and retaining employees rather than entering liquidation and removing jobs from the economy.

- Create a new status on ASIC's Company Register called 'Under restructuring' which is triggered on the appointment of a restructuring practitioner to a company.

  Current ASIC statistics on the types of external administrations indicate an exponential increase in directors appointing a restructuring practitioner to their company coupled with an increase in the proportion of plans that are made. This would indicate that this small business reform is gaining traction with directors of small businesses and liquidators.

  Unfortunately, making such an appointment is considered an act of insolvency and the status of the company changed to 'Under external administration' even though when a plan is agreed to and made, the status of the company reverts to 'Registered'. This temporary status causes significant harm to the company trying to restructure. Many key insurance policies are made void and the company's reputation is damaged.

  This impact of a change in status is contrary to the essence of the reform, to leave the directors in control of the company so it can continue trading. We consider our recommendation strikes the appropriate balance between facilitating the continued operation of the business and keeping the public aware of the status of a company at any given point in time.

- The Australian Securities and Investment Commission (ASIC) to publish its interpretation of the law of the information required in each statutory report submitted under corporate insolvencies.

  For efficient, fair and affordable insolvency options, key Government agencies must seek only the information required by law and, ideally, have systems that require key data to be submitted once.

  For example, ASIC requires liquidators to answer if they have identified any phoenix activity but does not define phoenix activity. ASIC also require liquidators to report when they are appointed to a company and then publish the same information on ASIC's public notice board. Other agencies such as the Australian Taxation Office (ATO) also ask for more information than is required by law. For example, the ATO often requires a liquidator to compare the outcome under a restructuring plan against an estimated outcome if liquidated. While such a comparison is required under safe harbour, it is not required under the small business restructuring reform.

  We consider that by ASIC, the regulator, providing clarity of the information required under the law all parties, the liquidator, directors and other government agencies, will be able to work more effectively and optimise the outcome for a business and its stakeholders.

Our recommendations seek to encourage more directors to close their businesses through a formal process to release capital back into the economy for innovative and viable businesses. Further detail on these recommendations and additional matters for consideration has been provided against the Committee's terms of reference in Appendix A.

Sincerely,

Simon Grant FCA
Group Executive, Advocacy & International

Karen McWilliams FCA
Business Reform Leader

Appendix A

Please note: ASIC discontinued the reporting format that provided detail across external administration on 27 March 2020. Therefore, the period covered by some of the ASIC statistics quoted in the following is financial year 2018-19. ASIC plans to again provide this information, in a different format, in 2023. Though historical, we do think it reflects representative averages prior to the impact of the pandemic.

1. Recent and emerging trends in corporate insolvency

COVID 19 pandemic insolvency measure

Our members have found that the temporary insolvency measures that have since been enacted in law, such as holding virtual creditors meetings, are beneficial for all parties to external administration.

While we do not consider the statutory limit should be raised to the temporary level invoked during the pandemic, we do consider it needs to be adjusted to reflect the costs to a liquidator to complete the minimum statutory requirements, which apply irrespective of the value of the external administration.

Such an increase will ensure that, when a company cannot satisfy a statutory demand and liquidation is triggered, it is more likely that the company is under financial strain and should be investigated by a liquidator.

For consistency and simplicity, we recommend that limit be the same as the threshold to initiate a creditors' petition under the bankruptcy regime.

We recommend that the statutory demand threshold in the *Corporations Act 2001* (Cth) be raised to $10,000.

We consider the time frame to respond to a statutory demand of 21 days to be appropriate, particularly where the threshold is increased as recommended.

We would also suggest establishing laws that can be enacted when there is a shock to the Australian economy and the Government invokes its state of emergency powers. As the recent response to the pandemic is interrogated, a package of emergency insolvency measures that proved effective in the recent shock could be captured in an Omnibus Bill that can be enacted as needed.

Economic conditions

Inflationary pressures are hitting all businesses and our members expect the number of businesses facing financial stress to snowball in the coming months. In the absence of directors' taking action, due to the stigma attached to exiting the market, it is imperative the ATO seeks to collect its debts in a timely manner, to mitigate debt reaching unmanageable levels.

While the ATO works hard to encourage businesses to work with them to address debt, for those that enter payment plans, the debt due remains as the original date due. This can be a disincentive to enter a plan as, until it is paid in full, the business could be considered trading while insolvent. We suggested consideration be given to adjusting the due date for ATO taxation debt to the dates under the payment plan.

2. The operation of existing legislation, common law, regulations

Small Business Restructure reform

As is evident from ASIC statistics, the small business restructuring process is gaining traction. The intended purpose, to support directors of small businesses to enter a restructuring plan with creditors with the support of a small business restructuring practitioner, appears to be coming to fruition. Not only are more small businesses seeking to restructure but more restructuring plans are being accepted and made.

The eligibility criteria sought to balance saving a viable small business and that business meeting its obligations to employees and creditors. The eligibility criteria were designed on historical data prior to the implementation of reforms in 2021. It is appropriate to review the eligibility criteria now as the economy struggles to recover from the impact of the pandemic and current inflationary pressures heightened by international events.

We reviewed the eligibility criteria against the statistics published in ASIC Report 645 Insolvency statistics: External Administrators reports (Jul18-Jun19).

As the extract from table 33 indicates, potentially 75% of businesses entering external administration would have been eligible for a restructure based on having liabilities of less than $1 million. We consider this threshold should be reviewed against current statistics to determine if it remains reasonable in the current economic climate.

Extracted from Table 33: Amount of assets and liabilities (7,498 reports)

Liabilities	Number of reports	% of total reports
$1 to $250,000	2,857	38.1 %
$250,000 to less than $1m	**2,836**	**37.8%**

Table 35 indicates that over 80 per cent of businesses entering external administration had no outstanding employee entitlements, excluding superannuation. Table 37, extract below, indicates that 51 per cent also had no superannuation outstanding (that is 'Not applicable') and a further 37 per cent had less than $100,000 outstanding.

Extracted from Table 36: Amount owed un unpaid superannuation (7,498 reports)

Amount owed	Number of reports	% of total reports
$1 to $100,000	2,817	37.6%
$100,000 to $250,000	556	7.4%
…		
Not applicable	**3,893**	**51.9%**

Our members believe that the small business restructuring is saving businesses and saving jobs. If current statistics follow the historical trend, we do not see a significant increase in risk where the eligibility criteria are amended so companies have to be substantially up to date with payment of employee entitlements, including superannuation.

We recommend that the eligibility criteria to appoint a restructuring practitioner to a company be amended so that employee entitlements must be substantially up to date providing the restructuring plan first satisfies outstanding employee entitlements.

The reform is also intended to incentivise directors to act early while there is still a viable business to restructure. Therefore, it appears counterproductive to consider the appointment of a restructuring practitioner to a company to be an act of insolvency. Directors can take this step if they expect their business could become insolvent in the future, not only when it is insolvent.

On the appointment, the status of the company on ASIC’s register is changed to ‘under external administration’ and reverts to ‘registered’ on a plan being made. The change of status immediately renders many services underpinning the business void, for example, workers’ compensation insurance. This inhibits the ability of directors to keep their business trading.

We acknowledge that the public need to be aware of the status of the company at any given point but, as found by our members until you experience a restructuring you are not aware that the status of the company will change to ‘Under external administration’ or that this change is temporary.

We recommend creating a new status on the Company Register of ‘Under restructuring’ which is triggered on the appointment of a restructuring practitioner to a company.

A liquidator, in the role of a restructuring practitioner, provides advice and assists in preparing a plan. On providing the plan to creditors, they also provide a declaration that they consider the company can discharge the obligations of the plan as and when they become due. Yet the ATO, as a creditor, often also asks the liquidator to undertake further work - be it investigations or to provide a comparison of the outcome under the proposed plan to the potential outcome under liquidation.

As the ATO is often the highest value creditor and therefore a critical vote to have the plan accepted, liquidators feel they have little option but to undertake the additional work and provide requested information. The unintended consequence is that the costs of this additional work incurred by a liquidator accumulate, defeating the purpose of minimising the costs to the business as it attempts to restructure.

A further consequence has been to create uncertainty for liquidators as to the level of detail ASIC may require in its reports for a restructuring appointment. Accordingly, liquidators are providing the same level of information as they would for voluntary administrations to ensure they are compliant with ASIC’s expectations.

The law sought to minimise the cost to the business of appointing a restructuring practitioner to support the directors to develop and provide a restructuring plan to creditors. With minimal costs to the business, there are more cents in the dollar available to creditors under the plan. For this process to maximise the return to creditors, all parties to the process must embrace minimal reporting and trust the expertise of a restructuring practitioner, who must have an in-depth knowledge of insolvency law and years of experience undertaking external administrations, to identify and call out misconduct by directors and creditor-defeating transactions if identified.

As ASIC statistics show, the simplified liquidation process has rarely been utilised. Our members advise that, as they are unsure of the degree of investigation required by ASIC, they consider the best outcomes can be achieved with a full liquidation where the requirements to be compliant are known.

We consider more detailed guidance should be provided by the regulator, ASIC, for all parties in an insolvency to be clear on what information will be provided, and that they are expected to be satisfied with that information, under any particular form of corporate insolvency.

We recommend that ASIC publish its interpretation of the law of the information required in each statutory report submitted under corporate insolvencies.

Unlawful phoenix reforms

Further clarity is required from ASIC on the information they require to consider an application by a liquidator to make orders that a transaction is voidable. Currently, ASIC's guidance on its website states a liquidator 'will need to provide as much information and material as possible'. Unfortunately, what evidence a liquidator has may be limited as the action is a deliberate attempt to defeat creditors so directors may refuse to provide books and records to the liquidator.

Where limited information is available to a liquidator, they may apply to ASIC for funds to undertake further investigation. Our members must consider the time, therefore cost, to the external administration to work through these steps against the value of the transaction they report as possible phoenix activity before proceeding with further investigations. This process could be streamlined by ASIC providing specific guidance on the minimum information required to consider an application for orders.

While it is too early to see the impact of all the reforms, our members have found prohibiting the backdating of documents beneficial as it has led to more transparency on who is responsible for the company.

We would seek consideration of extending the time period to recover creditor-defeating transactions as there are many levers directors can pull to delay entering external administration for 12 months. For consistency, we would propose extending the look-back period to 2 years to be in line with other claim periods, such as insolvent trading.

Personal Property Securities Act

Our members are cognisant of the Act and encourage continued education to address the knowledge gap evident in directors to ensure they maximise the benefits afforded under the Act.

The current process favours the secured party as a discharge cannot be affected until a secured party has been given time, noting there is no limit on this time, to validate their registration.

As we have raised in other forums, we suggest adjusting the discharge process so a grantor can trigger discharge where the secured party is uncommunicative or reticent to take action themselves, thereby causing financial harm to the grantor.

For our members in insolvency, to meet the law on how assets are treated under external administrations, they must first determine which are secured, and which are unsecured, in a timely manner. Our members, now standing as the grantor, write to secured creditors seeking confirmation they have a valid registration to be considered secured and often the creditor does not reply, or they reply saying they are owed nothing but take no action to remove their registration.

We are aware changes to the discharge process have been raised by many in various forums and again we seek change so a request to discharge from a grantor can be affected by the Australian Financial Security Authority unless the secured party validates its registration within, say, 15 business days.

3. Other areas for potential reform

Unfair preference claims

We consider the ‘relation back period’ appropriate but suggest introducing a threshold where liquidators can pursue claims. That threshold should be the same as the statutory demand threshold.

Primarily to ensure that the value of a claim would be greater than the cost to pursue the claim, returning some value to the administration. Equally, this would provide protection to small-value, unsecured creditors, who may pay an invalid claim as they are not aware of the defences available.

Trusts with corporate trustees

We consider urgent reform is needed. In our submission to the Treasury on 9 December 2021 Clarifying the treatment of trusts we proposed:

- on the appointment of a liquidator to a corporation that also acts in the capacity of a trustee
  - an eviction clause in the related trust deed or deeds that would automatically remove a corporate trustee is not enforceable
  - a right of an appointer to appoint a new Trustee is not enforceable
- the Company Register includes notification if a corporation also stands as a trustee
  - a second tier of information providing the name of the Trust

We would be pleased to provide our full submission if desired.

Insolvent trading safe harbours

As provided in our submission to the Treasury on 8 October 2021 in regard to 'A Review of the insolvent trading safe harbour', we consider the safe harbour provision is currently being applied appropriately and successfully by directors of mid to large sized firms. We do not consider safe harbour a useful option, nor that it should be changed to make it a useful option, for directors of small to micro businesses due to better fit alternatives available such as the small business restructure process.

We would be pleased to provide our full submission if desired.

International approaches and developments

The key reform sought by our members is to amend the definition of insolvency to be more expansive. Currently, it is limited to when a company cannot pay all its debts when they fall due. IN many other jurisdictions there is a more holistic view. For example, in the United Kingdom, a company is insolvent if it has insufficient assets to discharge its debts and liabilities with several tests that can be applied.

Our members also alter you to the key issues that directors of small businesses, most businesses that make up external administrators, do not understand the term insolvent trading. Consideration could be given to using natural business language such as 'wrongful trading.

4. Supporting business access to corporate turnaround capabilities

We are supportive of a fund that can be accessed by small to medium businesses to engage a professional to assess the viability of their business. Where that assessment concludes a restructuring is the best option, we consider the small business restructuring reforms, noting our recommendations for change, and voluntary administration as the appropriate vehicles.

It is critical directors have access to professionals that have the skills and ethical standards to genuinely seek to turn around the business, not simply move assets into a new company leaving the original company a shell with debts.

5. The role, remuneration and financial viability of registered liquidators

It must be acknowledged that, once a liquidator has accepted an appointment, the law requires that the liquidator take personal responsibility for the company, undertake a minimum number of activities including verifying its financial position and creditors, establishing why it has entered external administration and sufficient investigation to identify if there has been misconduct by the directors. Then report their findings in voluminous reports to ASIC and creditors. Conversely, other professionals whose work is driven by law, such as solicitors and lawyers, can demand payment up front and cease work, irrespective of where a case is at, when the funds provided are exhausted.

Remuneration

Change is required to ensure liquidators receive payment for reasonable work undertaken in all external administrations. We consider there are two avenues to effect meaningful change, streamlining processes so they are proportional to the administration and increasing the maximum default remuneration.

Processes

Currently, processes are one-size-fits-all irrespective of the value of the administration or the number of creditors. The outcome is a disproportionate cost being borne by small-value administrations as a liquidator completes the minimum activities required by law and submits a raft of mandatory statutory reports to ASIC.

We recognise the need for transparency, but this must be balanced with the impact of the cost of transparency on the funds that will be available to distribute to creditors. For example, completing a highly detailed creditor report which is rarely, if ever, read by creditors of small value administrations, who in the main are unsecured small businesses and individuals. This could be addressed by allowing summary reports for small-value administrations and detailed reports for high-value administrations.

Using the total costs incurred by a liquidator as a measure of the complexity of an administration, we propose where a liquidator is seeking $50,000 or less in total costs, only a summary of activities, remuneration and external costs to be provided as standard with the right for a creditor to seek more detail.

Financial viability

The inflationary pressures in our economy compounded by a tight labour market have, as with all businesses, raised the cost base for liquidators to undertake even the minimum activities required by law for all insolvencies. As raised earlier, we consider the maximum default remuneration no longer reflects the cost to complete the minimum activities required by law and we seek an increase to $10,000.

This maximum default also denotes when a liquidator must seek creditor approval for their remuneration. Our members find that creditors will vote when they are against the remuneration sought by a liquidator but may not take the time to vote where they are not against the remuneration.

The outcome is that remuneration over the maximum default cannot be drawn as creditors have not voted in favour of that action. An increase in the default remuneration to cover minimum costs will remove the cost of calling a creditors meeting from small value administrations and ensure liquidators receive some remuneration to complete the minimum mandatory work required by law.

Where remuneration is greater than the maximum default amount and creditors seek to challenge the amount, the only avenue is to take the matter to court. While some challenges are valid, the majority of cases to date have been found in favour of the liquidator. As with any litigation, the cost can quickly exceed the potential pool of funds that would have been available to all creditors.

We seek for consideration for investing powers in the regulator, ASIC, to review and approve or decline remuneration sought by a liquidator. Such consideration could also set a threshold that requires a decision to be made by a court.

As an alternative, consider establishing a government litigation fund. This fund could provide grants to a liquidator to undertake further investigations, such as a public examination, where they suspect there has been misconduct or a creditor defeating transaction but there are no funds in the administration to progress action. This most often arises on appointments accepted from the courts and from the ATO. Where the liquidator is able to draw their remuneration and costs from the liquidation, the grant is repaid to the pool of funds available to other liquidators.

6. The role of government agencies

The role and effectiveness of ASIC

As provided in our submission to the Financial Regulator Assessment Authority on 31 August 2022 on 'ASICs effectiveness as a regulator', we concluded that ASIC is not transparent nor held accountable for their performance and is therefore not effective.

We would be pleased to provide our full submission if desired.

Our members call on ASIC to focus its enforcement activities in the corporate sector on improving the knowledge and accountability of directors. Liquidators frequently identify directors as being in breach of their obligations, yet very few of these directors are investigated.

Conversely, any complaint against a liquidator is investigated and when that investigation is made public, irrespective of the outcome, it damages a liquidator's reputation.

Currently, ASIC is quick to promote its wins across media and social media and post a record on its website. Yet, when ASIC is unsuccessful, they appear to only publish their loss on their website.

Even then, rather than publish the decision and clarify that a liquidator has not breached their duties, ASIC publishes an ambiguous statement. For example, '…continues to be registered as a liquidator as the Committee was not satisfied that her actions warranted disciplinary action and found that no other disciplinary action should be taken against her.'[1]

To address this potential damage to a liquidator's reputation, we seek for ASIC to equally promote cases where no fault is found against a liquidator as cases where the fault is found.

7. Related corporate insolvency matters

Director ID

We welcome the introduction of the director ID and believe it can play a significant role in educating directors on their responsibilities and obligations, in particular, how to identify financial stress and seek support.

In due course, consideration could be given to making the linkage between a director and a company dependent on that director acknowledging an online checklist that they understand their responsibilities, obligations and potential personal liabilities. This could also be incorporated into a regular update for directors in the future.

Official Liquidator

The statutory reporting requirements result in costs that a liquidator cannot recover from liquidations. It is unreasonable that liquidators, undertaking work for the Government by investigating businesses that have deregistered, or ASIC have deregistered, to ensure no creditor-defeating transactions have taken place have to bear the costs of meeting statutory reporting obligations.

To encourage directors to exit the market in a structured way, we seek consideration of establishing an Official Liquidator. Businesses without sufficient funds to appoint a liquidator can apply to the Official Liquidator to close their business. The Official Liquidator can transfer the company to a registered liquidator, and provide funds, where they consider there is value in undertaking investigations to identify if there has been misconduct by the directors or creditor defeating transactions.

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand (CA ANZ) represents more than 134,000 financial professionals, supporting them to build value and make a difference to the businesses, organisations and communities in which they work and live.

Around the world, Chartered Accountants are known for their integrity, financial skills, adaptability and the rigour of their professional education and training.

CA ANZ promotes the Chartered Accountant (CA) designation and high ethical standards, delivers world-class services and life-long education to members and advocates for the public good. We protect the reputation of the designation by ensuring members continue to comply with a code of ethics, backed by a robust discipline process. We also monitor Chartered Accountants who offer services directly to the public.

Our flagship CA Program, the pathway to becoming a Chartered Accountant, combines rigorous education with practical experience. Ongoing professional development helps members shape business decisions and remain relevant in a changing world.

We actively engage with governments, regulators and standard-setters on behalf of members and the profession to advocate in the public interest. Our thought leadership promotes prosperity in Australia and New Zealand.

Our support of the profession extends to affiliations with international accounting organisations.

We are a member of the International Federation of Accountants and are connected globally through Chartered Accountants Worldwide and the Global Accounting Alliance. Chartered Accountants Worldwide brings together members of 13 chartered accounting institutes to create a community of more than 1.8 million Chartered Accountants and students in more than 190 countries. CA ANZ is a founding member of the Global Accounting Alliance which is made up of 10 leading accounting bodies that together promote quality services, share information and collaborate on important international issues.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents more than 870,000 current and next generation accounting professionals across 179 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications.