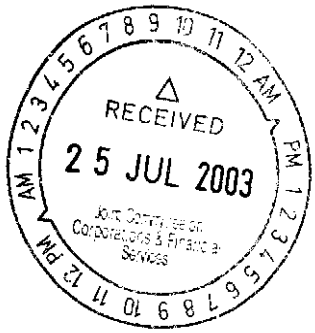

Insolvency Practitioners
Association of Australia
ABN 28 002 472 362

National Office
37 York Street
GPO Box 3921
Sydney NSW 2001
DX 1257 Sydney

P (02) 9290 5700
F (02) 9290 2820
www.ipaa.com.au

Dr Kathleen Dermody
The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Room SG.64
Parliament House
Canberra ACT 2600

23 July 2003

Dear Dr Dermody

Inquiry into Australia's Insolvency Laws
Supplementary submission in response to the Issues Paper

We refer to the IPAA's submission to the Joint Committee in relation to the Inquiry into Australia's Insolvency Laws dated 30 April 2003 ("our submission") and the Issues Paper released by the Joint Committee in mid May 2003 ("Issues Paper"). In our submission, we advised the Joint Committee that we would be making a further submission dealing with any additional points from the Issues Paper. This is the IPAA's supplementary submission.

We appreciate the opportunity to address the additional issues raised in the Issues Paper.

We have not answered every question in the Issues Paper. The headings from the Issues Paper, along with the questions that we have chosen to address, have been included in our submission. We have also numbered the questions included in this submission for ease of reference.

The appointment, removal and functions of administrators and liquidators

1. Is there a need to further strengthen the independence of administrators?

The IPAA believes there may be an issue of some insolvency practitioners offering inducements for the referral of work to other providers of professional services (for example other accounting firms and legal firms). To resolve this issue, we recommend that section 595 of the Corporations Act be extended to include not only members and creditors, but also directors and any other person or entity.

The IPAA draws the Joint Committee's attention to the new IPAA Statement of Best Practice: Independence on the Appointment of an Administrator ("SBPI"), which is effective from 1 July 2003. A copy of the SBPI is attached as Appendix 1. In summary, the SBPI requires Voluntary Administrators to provide full and proper disclosure of all factors impinging on, or likely to impinge on, the independence of the Appointee in the notice for the First Meeting of Creditors. The IPAA believes that the SBPI precludes the need for the strengthening of independence of Administrators in respect of its members.

The IPAA agrees with the comments made by Mr Colin Anderson and Mr David Morrison in their submission to the Joint Committee on the independence of administrators. A professional, highly qualified group of insolvency practitioners who are well aware of their duties to creditors can cure any issues associated with perceptions that administrators are beholden to directors. As such, it may be that standards required for registration need to be reviewed. The issue of registration of liquidators was considered in our submission at point 3.

2. ***Is it appropriate that companies are able to circumvent winding up proceedings (where a winding up application is pending but not yet determined) by appointing an administrator?***

It is the IPAA's opinion that companies should be able to appoint a Voluntary Administrator if a winding up application is pending. If a winding up application is pending, the Courts have the power to intervene and appoint a liquidator if, on the facts of the particular circumstance, it is warranted. However, generally creditors should be given the opportunity to decide whether they are better off with a proposed Deed or liquidation at the second meeting rather that this decision being made automatically for them.

However, if the company subsequently goes into Liquidation, the relation-back day should be defined to be the date of the filing of the application for the winding up of the company rather that the date that the Voluntary Administration commenced[1]. The altering of the definition of relation-back day should remove the incentive for directors to appoint a Voluntary Administrator to simply move the relation back day forward in time.

3. ***Can the operation of the law be improved where different forms of administration are potentially open and the parties seek different forms of external administration (eg. Voluntary administration or liquidation)?***

The recommendation made by the Legal Committee of CASAC in its final report on Corporate Voluntary Administrations ("CASAC report") that directors of a company to which a provisional liquidator has been appointed cannot appoint an administrator[2] was one of the recommendations included in Appendix 3 to our submission. Appendix 3 of our submission was a summary of what we saw as the most important recommendations from The Report of the Working Party on the Review of the regulation of Corporate Insolvency Practitioners and the CASAC Report that remained outstanding.

4. ***Should administrators or liquidators be able to be removed in a wider range of circumstances than is presently provided for under the law?***

The CASAC report recommended the following:

- Recommendation 50 – In addition to the Commission, a creditor or a member of a company should have the right to apply to the court for a replacement of an administrator[3]; and
- Recommendation 54 – Creditors should have the right to appoint their own nominee as liquidator when a company under administration goes into winding up. If creditors do not appoint their own nominee, the administrator or deed administrator should become the liquidator.

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[1] Recommendation 52 of the Report of the Legal Committee of CASAC in its final report on Corporate Voluntary Administrations. This recommendation was included in Appendix 3 of our submission as an important recommendation that remained outstanding.

[2] Recommendation 45

[3] The CASAC Report also recommended that liquidators or provisional liquidators should have this right.

The above recommendations were included in Appendix 3 to our submission.

5. ***What measures can be adopted to enhance the provision of information to creditors at statutory meetings of creditors under voluntary administration?***

The IPAA has addressed this issue by releasing a Statement of Best Practice: Content of Administrators Report pursuant to section 439A(4) of the Corporations Law ("SPBAR"). A copy of the SBPAR is included at Appendix 2.

The purpose of the SBPAR is to provide guidance to an administrator of a company in fulfilling his/her statutory responsibilities under the Corporations Law, specifically in preparing the administrator's report on the company's business, property, affairs, financial circumstances and proposal for a deed of company arrangement. It is the intention of the SBPAR to promote transparency in respect of the company's affairs, the relationship between the administrator and creditors and the relationship between the company and the administrator.

6. ***Would it be appropriate to extend the timeframe for the first and second statutory meetings of creditors under voluntary administration?***

The recommendations made in the CASAC report regarding extending the timeframe for the first and second meetings of creditors in a Voluntary Administration[4] were two of the outstanding recommendations included in Appendix 3 to our submission.

7. ***What measures should be introduced for dealing with assetless companies and what role can liquidators play in relation to assetless administrations?***

This issue was addressed at point 13 of our submission.

The duties of directors

8. ***What measures can be taken to improve director compliance with the provision of reports and information to administrators about companies' affairs on the commencement of external administration?***

In July 2002 ASIC commenced a program of work within the Complaints Management Program to assist external administrators to address ongoing misconduct by company officers. The program is called Complaints Compliance Actions ("CCA") and its functions include the prosecution of directors who fail to provide information required by law (books and records and reports as to affairs).

Based on information provided to Insolvency Practitioners by ASIC[5], it appears that ASIC is actively pursuing company directors for failure of provide RATAs, books and records to external administrators.

It is the IPAA's opinion that enforcement action, such as that being taken by ASIC, is the best means of ensuring compliance. Further legislation will not resolve the problem.

[4] Recommendations 2 and 6
[5] ASIC Insolvency Update April 2003

The rights of creditors

9. What features of the Voluntary Administration procedure are open to abuse or improvement?

Chairing of the Second Meeting of Creditors

The Corporations Regulations[6] currently provide that where a meeting is convened by an administrator of a company under administration the meeting must be chaired by the administrator or a person nominated by that person. However, the Corporations Act[7] states that at a meeting convened under section 439A (the second meeting of creditors in a Voluntary Administration) the administrator is to preside.

Due to the operation of Regulation 5.6.11(3)(c), where regulation 5.6.17 is inconsistent with a particular requirement of the Act, the regulation does not apply. Accordingly, it appears that for section 439A meetings, the administrator must chair the meeting.

It is the IPAA's opinion that this requirement is impractical. If for some reason the administrator is unable to attend the meting (for example due to ill health) the meeting is technically unable to be held. It is also unable to be adjourned.

The IPAA recommends that section 439B be amended to provide for a representative of the administrator to chair the meeting where the administrator is unable to.

For practical purposes Ministers of the Crown have the power to delegate many of their functions to officers of the crown. Similarly, administrators are seeking certain discretion in delegating some functions to their partners or staff.

10. Should the law give clearer guidance as to the manner in which a casting vote may be exercised by an administrator?

It is the IPAA's opinion that the casting vote is a valuable tool which, if exercised, can be used effectively by the administrator to overcome deadlocks in a way which allows the administrator to consider creditor's wishes.

Care must be taken in providing guidance on the use of casting votes. As can be seen from recent cases[8], the Courts have held that there are a wide range of factors which administrators should take into account when deciding how to use a casting vote.

However, the IPAA is supportive of a change which would prevent an administrator using a casting vote in a resolution in which he or she has a direct interest (for example: resolutions regarding his/her removal, resolutions regarding his/her fees). The casting vote could still be used in a resolution regarding the future of the company (for example: to accept a Deed of Company Arrangement or to place the company into liquidation).

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[6] Regulation 5.6.17(1)

[7] Section 439B

[8] *Young v Sherman* [2001] NSWSC 1020, *Cresvale Far East Ltd (in Liq) v Cresvale Securities Ltd (Subject to Deed of Company Arrangement) & Ors* [2001] NSWSC 89; *Soia & Ors v Internet Tuition College (administrator appointed)*, Unreported, Supreme Court of Western Australia per White AUJ, Re Martco Engineering Pty Ltd (1999) 32 ACSR 487,489, Re Coalleen Pty Ltd (1999) 17 ACLC 590.

Resolutions regarding the future of the company are probably the most effective place for the casting vote to be used. If the casting vote was not available, numerous companies would end up in limbo, with creditors unable to pass a resolution on any of the three available options under section 439C.

11. ***Should Australia adopt a debtor in possession business rescue regime along similar lines to Chapter 11 of the US Bankruptcy Code as an alternative to, or in place of, VA?***

This issue was addressed at point 1 of our submission.

12. ***Is their scope for the adoption of e-commerce technologies in corporate insolvency to help reduce the costs of external administration?***

This issue was addressed at point 7 of our submission.

13. ***The Committee invited comment on the rights of shareholders in corporate insolvencies.***

When considering the issue of shareholders rights in an insolvency context, it is important to balance shareholder's requests for information against the cost of providing that information. It must be remembered that in insolvencies there are insufficient funds available to pay creditors in full and thus, any requirements imposed upon the external administrator to communicate with shareholders will be funded by the creditors.

This issue was recognised by ASIC in their recently released Interim Policy Statement 174 – Externally Administered Companies: Financial Reporting and AGMs ("IPS 174"). In brief terms, IPS 174 provides external administrators of companies required to financially report or hold AGMs with guidance on how to apply for relief or extensions of time in respect of those obligations. IPS 174 recognises that external administrators should be granted relief where shareholders no longer have an ongoing economic interest in the company. The IPAA agrees with the principles included in IPS 174.

The cost of external administrations

14. ***How should fees for insolvency practitioners be determined? Can the means for disclosure of fees be improved? What form should such disclosure take?***

It is the IPAA's opinion that the principles set down in the Corporations Act are appropriate – agreement with creditors on the quantum, with the Courts maintaining a supervisory role or approving fees where creditors are unable to[9].

For IPAA Members, the requirements of the Corporations Act have been supplemented by the IPAA's Statement of Best Practice – Remuneration ("SBPR") dated 1 July 2000, which provides clear guidance on:

- the information that external administrators should provide to creditors when seeking approval of fees,
- the requirement to cap remuneration where it is approved prospectively;

[9] Sections 449E and 473 of the Corporations Act

- liaison with creditors regarding further enquiries and investigation in relation to the recovery of property where such inquiries and investigations could have the possible effect of reducing the amount of a dividend payable to creditors.

The IPAA is of the opinion that no further guidance is required in respect of its members. A copy of the SBPR is attached at Appendix 3 .

The treatment of employee entitlements

15. Commentators may wish to consider the design of the current – GEERS – and alternative schemes for the payment of employee entitlements.

The IPAA is supportive of the GEERS schemes and believes that it meets its objective of providing a safety net for employee entitlements.

However, the IPAA believes that the position of the Department of Employment and Workplace Relations ("DEWR") needs to be clarified so that it can, where payments are made under a scheme to employees, be an active participant in the insolvency process. This issue is discussed at point 6 of our submission.

16. Should schemes for the protection of employee entitlements be financed by government or industry?

The IPAA believes that rather than imposing responsibility on the government to protect entitlements or seeking greater protection through the Maximum Priority rule, greater responsibility should be placed on directors to ensure that those employee entitlements normally recognised on the balance sheet of the company are protected. In this way, responsible directors will take steps to avoid breaching their duties by ensuring that basic employee claims are met.

A government sponsored scheme, such as GEERS, provides the safety net in the event that directors do not fulfil their duties. However, to provide incentive for directors, we recommend that the Commonwealth take an active role, as a priority creditor by subrogation, in providing funding support for pursuing claims against directors to ensure that they are held more accountable for their actions.

17. Should employee entitlements have an absolute priority ahead of all other creditors, including secured creditors, upon liquidation?

The IPAA does not agree with the proposal that employee entitlements be given an absolute priority ahead of all other creditors upon liquidation. The reasons for our opinion are set out in details in the IPAA's submission to the Treasury discussion paper on Employee Entitlements: Proposal to give priority over secured creditors, which was included as Appendix 1 to our submission.

18. Should superannuation be given a higher priority in a corporate insolvency context?

The difficulty when assessing what priority should be afforded to Superannuation versus other employee entitlements is that most employees, when they are in the position of having just lost their job, would, if there were insufficient monies available to pay wages and superannuation in full, prefer to receive wages rather than superannuation.

However, this argument may not be as relevant in the current environment due to the fact that employees will generally received their entitlements (or a substantial proportion thereof) through GEERS – whether there are sufficient funds in the administration or not. Accordingly, the preferred course may now be for superannuation to have a higher priority as it is not covered by GEERS. In this way, employees will receive their entitlements, other that superannuation, from GEERS and will have a greater chance of their superannuation being paid from the administration as it would have a higher priority and would no longer be competing with a subrogated claim from GEERS pursuant to section 560.

Notwithstanding the issue about what priority superannuation should be given and whether it should be covered by GEERS, it is the IPAA's opinion that there are inconsistencies between the operation of the Superannuation Guarantee (Administration Act) and the Corporations Act in respect of the treatment of employee superannuation entitlements in an insolvency situation which significantly undermines the current priority afforded to superannuation. This issue is discussed at point 11 of our submission.

Compliance with, and effectiveness of, deed of company arrangement

19. Is there scope for improving the process for negotiating the terms of deeds of company arrangement?

One of the cornerstones of the Voluntary Administration process is that creditors have the final decision on the company's future. If creditors are not comfortable with the information provided by the Deed Administrator or do not agree with the proposed Deed, they can vote no. If a Deed is approved that they disagree with, they have the option of applying to the Court for termination of the Deed[10].

The Corporations Act provides for the prescribed provisions[11] to be altered[12].

The terms of the final Deed should reflect the intentions of creditors expressed at the meeting. The Issues paper notes that concerns have been expressed about Deeds not reflecting the intention of creditors, matters being included in the Deed which were not discussed or approved, open ended discretions being included in the Deed which were not approved or discussed and the prescribed provisions being amended. The IPAA believe that it is unrealistic for the Voluntary Administrator to provide the Deed in its final form with the notice of the second meeting. Accordingly, to ensure that creditors are aware of the final terms of the Deed, the IPAA has the following suggestions in respect of the Form 509E Notice to Creditors of Execution of a Deed of Company Arrangement. The Form 509E should include:

- instructions on how creditors can obtain a copy of the Deed rather than just where the Deed can be inspected; and / or
- a summary of the final terms of the Deed (this would not be required to be published in the advertisement); and /or
- details of creditors' rights if they believe that the terms of the Deed do not reflect what was agreed at the meeting.

It is the IPAA's opinion that if creditors believe that the final terms of the Deed do not reflect what was agreed at the meeting, an application to Court should not be their only option. Creditors should be able to lodge a complaint with the Deed Administrator and ASIC, and as

[10] Section 445D of the Corporations Act
[11] Schedule 8A of the Corporations Act
[12] Section 444A(5) of the Corporations Act

regulator, ASIC should investigate the complaint. Many perceived problems may be able to be resolved through better communication.

The ATO in their submission to the Joint Committee proposed that Deeds should not be able to "discriminate" against certain creditors or classes of creditors. The IPAA disagrees with the ATO's arguments. In the cases on this point, the fundamental factor which allowed the Deed to continue was that, notwithstanding the discrimination, the Deed was no less beneficial to all creditors than a winding up[13]. It is the IPAA's view that, even if a Deed is discriminatory, if it provides for a better return to creditors than the immediate winding up of the company then the objectives of Part 5.3A have been met.

Whether special provision should be made regarding the use of phoenix companies

20. What other measures can be adopted to reduce the incidence of fraudulent phoenix company activity?

This issue was covered at point 13 of our submission.

* * * * *

Our President, Mr Bruce Carter, would be pleased to discuss this supplementary submission along with the IPAA's initial submission with the Joint Committee.

Yours faithfully

B J Carter
President

Attachments:
Appendix 1: IPAA Statement of Best Practice: Independence on the Appointment of an Administrator
Appendix 2: IPAA Statement of Best Practice: Content of Administrators Report pursuant to section 439A(4) of the Corporations Law
Appendix 3: IPAA Statement of Best Practice: Remuneration

[13] *Lam Soon Australia Pty Ltd (Administrator Appointed) v Molit (No 55) Pty Ltd* (1996) 14 ACLC 1,737

Appendix 1

Insolvency Practitioners
Association of Australia
ABN 28 002 472 362

Statement of Best Practice

Independence on the Appointment of an Administrator

(Pursuant to Part 5.3A of Corporations Act 2001)

Effective 1 July 2003

Prepared by the IPAA
Technical and National Committee
Sydney 31 March 2003

Statement of Best Practice – Independence : 1 July 2003

Appointment of an Administrator pursuant to Part 5.3A of the Corporations Act 2001

On 31 March 2003, under introduction from the President, the IPAA National Committee advised all Members, Judiciary, Registrars and Regulators that with effect from 1 July 2003 the following Best Practice should be applied to all Administrators appointed or nominated as an alternative Administrator at the First Meeting of Creditors.

Objective

The appointment of an Administrator is usually at the instigation of the directors or occasionally by the liquidator or the dominant secured creditor, with creditors having the right to nominate and vote for an alternative at the First Meeting of Creditors.

The concept of independence, in situation, attitude and action, is well established in all existing legislation, professional codes and literature.(1)

The objective therefore is to disclose all prior relationships of the Administrator or his/her firm at the time of nominations and appointments to ensure the public and creditors have continued confidence in the independence of insolvency practitioners.

Background

The very few statutory restrictions to appointments are noted in s.448 of the Corporations Act 2001 and are paraphrased in the IPAA Code of Professional Conduct quite clearly in sections 2, 3 and 4 of that Code.

The emphasis on the independence of the Administrator is due to the uniqueness of this particular appointment since the Administrator immediately assumes control of the company and investigates the reasons leading to its financial and business position.(2)

The Administrator is then required within a very short time, usually twenty eight days and no more than sixty days with extensions, to prepare a Report to Creditors on the company's business, property, affairs and financial circumstances and provide his or her opinion, and reasons for that opinion, on each of the following recommendations(3) :

1. The Administration end and the company returned to existing directors.

2. A Deed of Company Arrangement which invariably requires some form of concessions or co-operation of creditors.

3. Put company into Liquidation.

Given such a demanding and impartial role, and where interests of the directors can often differ from those of the creditors, the perception and confidence of Independence becomes even more important.

In some circumstances, such as close family or personal relationships, the potential for conflict is so great that the appointee should normally not consent to act. Such circumstances would also include where the appointee is acting as Trustee of the estate of one of the directors seeking relief under arrangements provided for within the Bankruptcy Act.

In these circumstances, if the Administrator still wishes to consent, he should fully disclose and explain why there would be no conflict to his Independence in these circumstances.

While nothing in this Statement, other than statutory limitations, shall restrict the appointment of any properly nominated and eligible appointee, it is essential that full and proper disclosure of all factors impinging on, or likely to impinge on, the independence of the Appointee, be made in the notice for the First Meeting of Creditors.

Disclosure

In the Notice of the First Meeting of Creditors at which the Administrator's appointment is considered, the Administrator shall, *at a minimum*:

- Provide the relevant details of his/her background and that of the Firm.
- Provide the proposed basis of remuneration in accordance with IPAA Statement of Best Practice - Remuneration.
- Provide the relevant details of prior professional or advisory relationship with:

  (a) The directors and officers or their associated businesses;

  (b) The company, holding or subsidiary companies within the meaning of Corporate Groups;

  (c) Any dominant creditor, be it the secured lender, usually a financial institution, or dominant and critical trade supplier, in advising such parties concerning the company;

  (d) Any other prior professional or advisory relationship concerning the company, e.g. acting for employees or the dominant Union.

In making this requirement, allowance must be made for practical commercial reality.

For example, in a large group of companies and where the practitioner is a member of a large firm, it cannot reasonably be expected that every branch, subsidiary or creditor can be checked for every possible prior relationship that might have existed within that firm's practice, at least at the time the notice to creditors is dispatched.

Nevertheless, in most cases, the prior professional relationships such as Investigating Accountants, credit appraisal or prior monitoring role whether formal or informal, on behalf of a major creditor or director, is usually well known and must be disclosed.

The Administrator shall state that he/she has consciously considered the question and to the best of his or her information there are no such prior or personal relationships, other than those disclosed, of which the creditors should properly be aware at the First Meeting of Creditors and prior to the voting on any alternate appointment.

Alternate Nomination

In cases, where an alternative nomination is put before the First Meeting of Creditors then:

a) The alternate nominee is bound by the same rules of disclosure as the appointed Administrator and must table the same disclosure information at the meeting; and

b) Follow the same established procedures as set out in Codes of Professional Conduct and of the Accounting Profession and the IPAA.[1]

This ensures the voting for an alternate is based on factors in addition to Independence.

Inducements

It is recognised that networks between professionals do exist, based on quality of service and prior experience with practitioners. However any method of referral must abide the professional, ethical and conduct guidelines of the IPAA and its Foundation bodies.

It is well established in all these professional, ethical and conduct guidelines noted above, that referral commissions, spotter's fees, recurring commissions or proposals for nomination conditional upon referred work, *are prohibited.*

This prohibition *does not extend* to commission or percentage of assets realised, when such risk sharing arrangements are clearly disclosed in the remuneration proposals, whether under the terms of the appointment or the subsequent management of any Deed. Refer IPAA Statement of Best Practice – Remuneration.

Conclusion

This Statement removes some of the former non-statutory and arbitrary restrictions in favour of wider eligibility, subject to proper disclosure.

Given the uniqueness of each appointment, the IPAA has no desire to introduce practices that are mechanical or prescriptive. It is the substance and intention of the Statement, not the prescribed form or the style and extent of detail that each Nominee or Firm should follow.

This Statement also confirms what is Best Practice for *any* Professional Appointment and will form a part of the IPAA Code of Professional Conduct.

This Statement of Best Practice shall be effective for all Appointments and Nominations of an Administrator after 1 July 2003.

(1) *Corporations Act 2001*, s.448C

Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia *APS 7 Statement of Insolvency Standards (1998)*

IPAA *Code of Professional Conduct (2001)*

Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia, *Section F1 – Professional Independence (2002)*

(2) *Corporations Act 2001, s.437A*

(3) *Corporations Act 2001, s.439A*

Appendix 2

Statement of Best Practice

Content of an Administrators Report

Pursuant to Section 439A(4)

Of the Corporations Law

Effective 1 July 2001

Prepared by the IPAA
Technical Committee
Sydney 31 May 2001

Contents of Statement

1 INTRODUCTION

The Insolvency Practitioners Association of Australia ("the IPAA") is committed to quality and professionalism in the practice of insolvency and expresses that commitment through the adoption of Insolvency Practice Statements. These Statements are intended to encourage consistency within the profession.

The Insolvency Practice Statements are intended to allow the practitioner to exercise professional judgment. The exercise of professional judgment on the facts available is fundamental to the quality of work performed. In providing guidance for the exercise of professional judgment, the following convention has been adopted:

a) "May" - Where it says that the member may take a course of action, the Insolvency Practice Statement is simply intended to be helpful and the member has full discretion to follow it or not.

b) "Should" - Where it says the member should take a course of action, it is appropriate to do so in most circumstances. Where a member judges it appropriate to do otherwise, the member should consider the advisability of documenting the reasons for his decision.

c) "Shall" - Where it says the member shall take a course of action, the Insolvency Practice Statement is mandatory and the member must follow it.

In these Standards, words importing the singular number or the masculine gender only include more persons, parties or things of the same kind than one, and females as well as males and the converse.

These Standards of Professional Practice are meant to complement and should be regarded as additional to any statutory obligations that members may have in carrying out their responsibilities.

2 OBJECTIVE

The purpose of this Insolvency Practice Statement is to provide guidance to an administrator of a company in fulfilling his statutory responsibilities under the Corporations Law, specifically in preparing the administrator's report on the company's business, property, affairs, financial circumstances and proposal for a deed of company arrangement. It is the intention of this Insolvency Practice Statement to promote transparency in respect of the company's affairs, the relationship between the administrator and creditors and the relationship between the company and the administrator.

3 BACKGROUND

Subsection 439A(4) of the the Law requires the administrator to include with the notice convening the second meeting of creditors a copy of:

(a) a report by the administrator about the company's business, property, affairs and financial circumstances; and

(b) a statement setting out the administrator's opinion about each of the following matters:

(i) whether it would be in the creditors' interests for the company to execute a deed of company arrangement;

(ii) whether it would be in the creditors' interests for the administration to end;

(iii) whether it would be in the creditors' interests for the company to be wound up;

and his or her reasons for those opinions; and

(c) if a deed of company arrangement is proposed, a statement setting out details of the proposed deed.

The administrator's role in a Part 5.3A administration is best described as that of an impartial expert. The administrator's primary duty is owed to the company's creditors. In reporting, the administrator must investigate the company's business, property and affairs. The administrator is required to form an opinion as to whether it would be in the creditors' interest, about each of the three alternative outcomes to the administration.

4 PROFESSIONAL JUDGEMENT

Companies to which administrators are appointed vary in size, business conducted, structure and type of creditors. The extent of investigations performed by an administrator is dependent on many factors. These factors include the limited, strict time frames prescribed by Part 5.3A of the Law; the nature of the proposal, if any, for the future of the company; as well as the size, business conducted and structure of the company. Accordingly, the administrator must exercise professional judgment in the preparation of the report required by subsection 439A(4) of the Law. It is implicitly recognised that the extent of compliance with this Insolvency Practice Statement will vary depending on whether a deed of company arrangement is proposed or the company is to be wound up.

The administrator has a statutory duty to investigate the company's business, property and affairs. Section 545 of the Law has no application to Part 5.3A. The statutory duty to investigate the company's business, property and affairs cannot be contractually restricted or limited by the administrator.

5 GUIDANCE FROM OTHER SOURCES

Auditing standards, whilst not directly applicable to the duties performed by an administrator, can provide guidance to the administrator in the conduct of the administrator's investigation. Auditing standards with some applicability include:

AUS 804	The Audit of Prospective Financial Information
AUS 512	Analytical Procedures
AUS 902	Review of Financial Reports

6 DEFINITIONS

In this insolvency practice statement:

"administrator" means an administrator of a company appointed under Part 5.3A of the Law

"administrators report" means

(i) a report on the company's business, property, affairs and financial circumstances required to be given to creditors pursuant to subsection 439A(4) of the Law; and

(ii) a statement pursuant to paragraph 439A(4)(b) of the Law, setting out the administrators opinion and reasons therefore, as to each of the options available in respect of the company's future in accordance with section 439C of the Law.

"auditing standards" means standards issued from time to time by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia.

"best estimate assumption" means an assumption that the person believes reflects the most probable set of economic conditions and planned courses of action; they are suitably supported, consistent with the plans of the person and provide a reasonable basis for the financial forecasts;

"company" means a company to which an administrator has been appointed pursuant to sections 436A, 436B or 436C of the Law;

"director" has the meaning given by sections 9 and 60 and of the Law;

"forecast" means prospective financial information prepared on the basis of assumptions as to future events expected to take place, and the actions expected to to be taken as of the date the information is prepared (best estimate assumptions);

"investigation" means

(i) the investigation of the company's business, property, affairs and financial circumstances, and

(ii) the review of the of the proposed deed of company arrangement and other options available to the company in respect of the company's future in accordance with section 439C of the Law,

required to be performed by the administrator pursuant to section 438A the Law;

"Law" means the *Corporations Law*;

"officer" has the meaning given by section 9 of the Law;

"projection" means prospective financial information prepared on the basis of:

(i) hypothetical assumptions about future events and management actions which are not necessarily expected to take place, such as when some entities are in a start-up phase or are considering a major change in the nature of operations; or

(ii) a mixture of best estimate and hypothetical assumptions,

such information illustrates the possible consequences, as of the date the information is prepared, if the events and actions were to occur (a what-if scenario);

"proposed deed of company arrangement" means the arrangement or arrangements proposed for the future of the company, by a person or persons pursuant to Part 5.3A of the Law ;

"prospective financial information" means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It is highly subjective in nature and its preparation requires the exercise of considerable judgement. Prospective financial information can be in the form of a forecast, or projection or a combination of both, for example a one year forecast plus a five year projection;

"voidable transactions" means those transactions in respect of which money, property or other benefits may be recovered by a liquidator under Part 5.7B of the Law.

7 CONTENT OF THE ADMINISTRATOR'S REPORT

7.1 Background Information

The administrator's report shall contain sufficient information to provide creditors with an understanding of the history of the company and the circumstances leading up to and the need for the appointment of a Voluntary Administrator.

7.1.1 Shareholders and Officers

The administrator's report shall incorporate details of the company's existing shareholders and officers and details of registered charges. Changes in these details that have occurred within twelve months before the administrator's appointment should also be disclosed.

7.1.2 Books and records

Failure to maintain books and records in accordance with section 286 of the Law provides a rebuttable presumption of insolvency. This presumption can be relied upon by a liquidator in an application for compensation for insolvent trading and other actions for recoveries pursuant to Division 2 of Part 5.7B of the Law from related entities. Accordingly, it is considered material to a creditor's decision concerning the company's future.

The administrator's report should incorporate an opinion as to whether the company's books and records are maintained in accordance with section 286 of the Law.

7.1.3 Financial statements

A company's financial statements are an essential tool in the management of the business conducted by the company. The presence, or absence, of timely financial reporting in a company may provide an indication of the management capabilities of the incumbent company officers. Accordingly, it is considered material to a creditor's decision concerning the company's future.

The administrator's report should disclose the date to which the company's financial statements were prepared prior to the administrator's appointment.

7.1.4 Historical financial performance

The administrator's report shall incorporate a summary of the company's historical financial results and a preliminary analysis and commentary thereon. For guidance, refer to AUS 512 'Analytical Review' and AUS 902 'Review of Financial Reports'.

7.2 Administrator's prior involvement

Whilst it is acknowledged that the administrator should detail his prior involvement with the company at the first meeting of creditors, the administrator's report should reiterate those circumstances and disclose any prior involvement with the company, its officers or any related parties.

7.3 Current financial position of the company

7.3.1 Directors' report as to affairs

The administrator's report should outline the content of the directors' report as to affairs and include the administrator's comments as to the administrator's estimate of realisable value of assets and liabilities.

7.3.2 Explanations for difficulties

The administrator's report shall include the directors' explanation for the company's difficulties and the administrator's opinion on the reasons for the company's difficulties.

7.3.3 Outstanding winding up applications

A creditor incurs substantial costs in making an application to have a company wound up. The timing of a company's decision to appoint an administrator, relative to the date on which the application was to be heard, may be a material factor to creditors in deciding the company's future.

The administrator's report should disclose any winding up applications filed against the company prior to the appointment of the administrator and the petitioning creditor in such applications.

7.3.4 Related entities

A creditor of the company may apply to the court to set aside or modify a resolution authorising the execution of a deed of company arrangement if the resolution was carried as a consequence of a related entity casting a vote. Similarly, a defeated resolution for the company to be wound up may be declared to have been carried, if it was defeated because of the vote cast by a related entity.

The administrator's report shall disclose those creditors of the company who are related entities and the quantum of their claims.

7.4 Offences, voidable transactions and insolvent trading

The administrator is required to complete and lodge a report pursuant to section 438D of the Law, with the Australian Securities and Investments Commission, in prescribed circumstances, including where the administrator suspects offences have been committed.

The administrator may disclose the suspected offences in the administrator's report, where they appear materially relevant to the creditors' decision on the company's future.

The administrator's report should disclose the quantum of any voidable transactions identified during the investigation and may disclose the beneficiaries of those transactions. Voidable transactions include unfair preferences (s.588FA), uncommercial transactions (s.588FB), insolvent transactions (s.588FC) and unfair loans (s.588FD). The administrator's report shall include comment regarding whether the company engaged in insolvent trading and may provide an estimate of the loss incurred by the company as a result.

In forming an opinion on likely recoveries from successful litigation against a company officer, the administrator must establish the officer's capacity to pay any judgement obtained. The administrator, due to time constraints, is unlikely to conduct a public examination of the company's directors. Therefore the administrator will be limited to public information and information provided by the director, or authorised by the director to be disclosed by third parties.

The administrator's report should disclose a director's personal financial position where the director intends to maintain an interest in the company after the proposed deed is executed, if the director may be liable to compensate the company as a result of an antecedent transaction or insolvent trading in a winding up. When a director does not provide this information, or authorise its disclosure by third parties, this should be disclosed in the report.

7.5 Estimated return from a winding up

The administrator's report shall disclose:

(i) the estimated return to creditors from a winding up of the company, and

(ii) likely timing of the return to creditors from a winding up of the company, and

(iii) disclose the basis on which remuneration will be sought by the liquidator and an estimate of the likely costs of administering the winding up of the company.

7.6 Proposal for a deed of company arrangement

Where a Deed of Company Arrangement is being proposed, the administrator's report should disclose:

(i) the key features of the proposed Deed;

(ii) the estimated return to creditors and likely timing of the return to creditors from the proposed Deed;

(iii) the monitoring and reporting arrangements that are to be put in place to ensure that the terms of the Deed are met and that creditors are fully informed of the progress of the administration;

(iv) a summary of the administrator's reasoning as to why the Deed will provide creditors with a greater return than in a liquidation, and if future trading under the Deed is contemplated, how the intended trading will enhance the return to creditors given the trading position of the Company prior to the administrator's involvement;

(v) Subject to commercial confidentiality, a summary of the prospective financial information relied upon for the proposed deed of company arrangement and the assumptions relied upon in the preparation of the prospective financial information;

(vi) subject to commercial confidentiality, a comment on the validity of the assumptions relied upon in the preparation of the prospective financial information, if the prospective financial information was prepared by a third party. If the prospective financial information was prepared by the administrator, the administrator should summarise the key assumptions relied upon in the preparation of the prospective financial information. For guidance, refer to AUS 804 'The Audit of Prospective Financial Information'.

(vii) in circumstances where a guarantor proposes to retain control of the business pursuant to the proposed Deed, details of the creditors holding the guarantees and the quantum of the debt secured by the guarantees. The report should request that any creditor holding a guarantee which is not disclosed in the report provide details to the administrator as soon as possible;

and the administrator's report shall disclose:

(viii) the basis on which remuneration will be sought by the administrator and an estimate of total remuneration sought by the administrator.

(ix) the basis on which remuneration will be sought by the administrator of the proposed Deed and an estimate of the total remuneration payable for administering the proposed Deed.

7.7 Administrator's recommendation

The administrator shall express an opinion and reasons for the opinion, as to whether the option is in the creditors' interests, in regard to each of the options available to the creditors to decide pursuant to section 439C of the *Corporations Law.*

The administrator should advise creditors in writing, if practicable, of any additional matter that comes to the administrator's attention after the dispatch of the administrator's report that a reasonable person would consider to be material to the creditors' decision.

8 OTHER MATERIAL INFORMATION

The administrator's report shall include any other information that is materially relevant to the creditors' decision on the company's future.

NOTES

Appendix 3

Statement of Best Practice - Remuneration : 1 July 2000

On 31 March 2000, under covering letter from the President, the IPAA National Committee advised all Members, Judiciary and Regulators that with effect from 1 July 2000, the Insolvency Practitioners Association of Australia would cease production of the IPAA Guide to Hourly Rates Scale and Staff Classifications and the reasons why.

Instead, Practitioners and Firms should charge hourly rates in accordance with their own internal cost structures having regard to the complexity and demands of each appointment. This decision had already been foreshadowed in the 1999 Guide to Fees and Explanatory Notes.

This first Statement, therefore, covers the transition.

Creditors and Courts are the final arbiters on the quantum of fees charged by a member and our Statement will continue to be sent to the various State Supreme Courts, the Federal Court, the Australian Securities and Investments Commission and Insolvency and Trustee Service Australia for their information. Their input to the approach and operation of this Statement has been most helpful.

This philosophy to change from a scale to individual charge rates is totally consistent with the basis used by the Institute of Chartered Accountants of Australia and the Australian Law Societies recently embodied within the Legal Profession Acts.

The Corporations Law is silent on the basis of fees other than the general principle of Creditors' approval. The Bankruptcy Act 1966 is, however, more specific and the Joint Statement of Personal Insolvency National Standards between ITSA and IPAA issued in October 1999 gives clear guidance on the basis and minimum disclosure required as Best Practice which should be applied to all insolvency appointments.

This Statement of Best Practice - Remuneration, therefore, addresses eight issues:

- Key Definitions
- Recognition of the continuing principles of the former Guide to Fees
- Introduction of new minimum disclosure of fee content
- Capping
- Transitional issues relating to appointments prior to 30 June 2000
- Specific issues relating to the Bankruptcy Act and Regulations
- Presentation and disclosure for Court Appointments
- Best Practice regarding disclosure and recovery of GST from 1 July 2000

Key Definitions

"*Administration*" is used generically to cover all forms of administration for insolvent or incapacitated entities.

"*Appointee*" is used generically to cover all insolvency administration appointments, both under the Corporations Law and the Bankruptcy Act.

"The Firms Fee Structure" means the rate per hour that the Appointee or the Firm of the Appointee proposes to charge to the administration for the principals and staff, based on the perceived complexity and demands of the administration and those most suitable with relevant experience to be assigned to it.

"*Capping*" means a broad estimate for each phase of work that creditors may rely upon having approved the phase and cost. The principle of estimation and capping is also consistent with the new procedures for Lawyers under the Legal Profession Acts.

Recognition of Continuing Principles

In insolvency matters, remuneration is usually dependent upon the manner of appointment and the relevant statutes. It is recognised that in work of this nature, the extent and urgency of the work, the degree of skill required, and the degree of responsibility undertaken can and does vary considerably.

Insolvency work tends to lack the regularity of most general practice and demands the availability of staff with particular skills, often with little or no prior notice. This generally results in the need to have sufficient staff to meet unexpected and sudden assignments and, in consequence, individual *charge out rates* for this type of work could *tend to be higher* than for other professional work.

In most cases, it is necessary to set out the basis of fees and hourly rate in a document of appointment, a resolution of creditors, or in a formal application to a court.

The IPAA recommends that in most insolvency appointments the fixation of fees be upon a basis of time spent at the level appropriate to the work performed. This is consistent with the conclusion of the Review of the Regulation of Corporate Insolvency Practitioners in 1997.

Alternative methods of calculation, such as percentage of realisations, a percentage of funds distributed, a lump sum or a combination of bases could be warranted in specific cases. However, as a general rule, fees based on time spent is the normal basis.

When calculating an appropriate fee, there should, therefore, be a careful review of the quality and quantity of work performed ensuring that the staff mix and average rate is commensurate with the nature and complexity of work done. This is the most important test of all.

Introduction to Minimum Disclosure

Where an Appointee or the Firm seeks to take remuneration calculated by reference to an hourly or time unit rate *creditors should be provided with details* of the:

- Type of work to be undertaken by the Appointee and the Firm's staff
- Estimated breakdown of the broad activity phases
- Relevant experience of each person
- Number of hours charged by each person
- Hourly rate charged for each person
- Total remuneration claimed
- Basis of recovering disbursements

Where a range of services is offered by the Firm, that might be regarded by some as ancillary to the core insolvency process, the Appointee should ensure that creditors *understand and approve these ancillary services* offered and utilised. The most common are assistance in bringing Records up to date, computation of Employee Entitlements, GST if in arrears and assisting in the preparation of a preliminary Statement of Affairs or Report as to Affairs notwithstanding the contents of which remains the responsibility of the bankrupt or debtor or the directors.

The Appointee must be able to demonstrate that *a task was necessary to be undertaken* for the proper conduct of the administration and that the time charged was reasonable for the task concerned.

Creditors are to be kept informed as to progress in the administration and this will include advice as to the level of the remuneration and disbursements incurred or paid.

The Appointee should take special care to have *regard to the understanding and views of creditors* in determining the extent of work undertaken in an administration. This applies particularly where *further enquiries* and investigation *in relation to the recovery of property* undertaken by the Appointee could have the possible effect of reducing the amount of a dividend payable to creditors from funds held in the administration if unsuccessful.

Capping

The resolution for approval of remuneration under both the Corporations Law and Bankruptcy Act should show the basis and include a specified amount. Where remuneration is approved prospectively, an upper limit must be included in the resolution of Creditors or Committee of Inspection.

If an amount is not specified or the amount specified is exceeded, it will be necessary to seek approval for a specified amount or for the additional amount, not dissimilar to the Letters of Engagement and Understanding for any other professional appointment.

Transitional Arrangements from 30 June 2000

There is full recognition of Appointments taken on prior to 30 June 2000 where the remuneration rate per hour was based on the former IPAA Scale. Quite clearly these should continue on the basis previously agreed with Creditors for the appointments made at that time unless subsequently varied in the normal course of the Administration.

Bankruptcy Act 1966

Unlike the Corporations Law, there are quite specific Statutory Remuneration Regulations in addition to the broad principles set out above. The significant sections are set out in Part VIII Division 2 and Regulations Division 4.

In this connection, a special default Regulation 8.08 stemming from S.162(4) was inserted to permit the drawing of fees at 85% of the IPAA Scale where it was not practical or not cost effective to call to a meeting of Creditors or Committee of Inspection to approve fees

It was *never the intention* that this privilege of a default clause be used as the general basis for Fees for Bankruptcy and nor should it be. As a concession to the continuance of this regulation as a default, and only a default, ITSA will accept fees based on 85% of the former IPAA Scale with no indexation. In these circumstances, Trustees should minute and circulate the reasons why the default was used advising the creditors and bankrupts of their right to request taxing.

The default concession does not apply to any Composition Arrangements reached with Creditors under Part X or compositions under S.73 where the fees must be declared and approved.

Court Appointments

The Courts have been broadly content to rely on the former IPAA Scale as the starting point for Provisional Liquidators, Court appointed Liquidators and as a starting point in applications by Creditors to the Court to have disputed fees reviewed e.g. arising from a Voluntary Administration.

It is significant that the Courts have consistently been more concerned at the appropriateness of the hours worked and the appropriateness of the level of staff used and value added rather than the actual rate per hour.

The prospective nominee for Court Appointments should, therefore, advise the Court of the fee basis to be used for the assignment based on the principles stated above. The table of the firm hourly rates to be charged for the appointment should form part of the Consent to Act.

In the case of Voluntary Administrations it is also recommended the nominee should table the proposed charge out rates at the first meeting of Creditors.

GST

GST is *a transaction tax on services ultimately borne by the end consumer.* It is not remuneration.

Fee invoices should clearly show the fee remuneration plus GST as a separate item to allow the correct processing for recovery of the input tax credit by the incapacitated entity or the bankrupt estate and/or to be reversed back as an adjusting item if not recoverable.

The same apportionment between the Cost and the GST should also be clearly set out in any claim for disbursements where the disbursements have themselves been subject to GST.

With regard to input taxed entities, such as financial institutions, the same procedure should be adopted. However, since the input taxed entity is subject to a *Reduced Input Tax Credit* of 75% for authorised services of which insolvency assignments and asset recovery services have been paid, it is essential that the basis for the recovery of the RITC is fully understood between the parties and documented. It was never the intention that the service provider should suffer the consequences of reduced input tax credits.

This is most likely in receivership or special debt recovery assignments. In practice, any shortfall in recoverable tax credits may well be recoverable from the assets of the borrowing entity if covered under the documentation for the secured borrowing costs, or the financial institutions may be able to compromise in setting the fees to be charged.

It is, therefore, *essential* that an unequivocal understanding on fees for appointments reporting directly to, or are paid directly by financial institutions, is reached to avoid dispute subsequent to appointment.

Conclusion

The above sets out the principles underlying Best Practices – Remuneration. Given the uniqueness of each Appointment, the IPAA has no desire to introduce practices that are purely mechanical or prescriptive.

In the experience of the IPAA, both empirically and anecdotally, Appointees and Firms that make the proper professional proposals of the fees to be charged have had little difficulty in obtaining approval from Creditors or the Courts and we expect this trend to continue.

On behalf of the IPAA
National Executive
Sydney, 25 October 2000

Appendix 1

Insolvency Practitioners Association of Australia
ACN 002 472 362

National Office
37 York Street
GPO Box 3921
Sydney NSW 2001
DX 1257 Sydney
Telephone
(02) 9290 5700
Facsimile
(02) 9290 2820

22 August 2002

Mr M.J. Kooymans
General Manager
Corporate Governments Division
The Treasury
Langton Crescent
PARKES ACT 2000

Dear Mr Kooymans

PRIORITY FOR EMPLOYEE ENTITLEMENTS

I refer to your letter of 30 July 2002 seeking submissions in relation to proposed changes to the Corporations Act and the introduction of a maximum priority rule relating to employee entitlements.

As Insolvency Practitioners, the members of the IPAA have been able to observe the behaviour of various stakeholders in insolvent businesses over a number of years. Also we have been an active participant in assisting the Commonwealth in understanding the issues relating to unpaid entitlements including providing advice prior to the commencement of EESS. We therefore believe that we are well placed to comment on any proposed changes to the legislation affecting employee entitlements.

In relation to the proposed changes, I wish to raise our observation that the assumed objective of the proposed changes is unlikely to be achieved due to the fact that the majority of unpaid employees of insolvencies are in small businesses and the proposed legislation only applies to large companies. We also note that, in relation to the most recent large company failure, being Ansett, it is unlikely that these proposed changes if applied to that administration would amount to any further return to employees or the Commonwealth due to the finance structure of that group.

I outline as follows our further observations:

ASSUMED OBJECTIVE

1. To protect maximum priority employee entitlements in the event of an insolvency.

2. To minimise Government's exposure to fund GEERS.

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COST OF UNPAID ENTITLEMENTS

In the EESS Year One Activity Report dated January 2001, it is noted that the annual cost of unpaid employee entitlements is in the order of $50 - $60 million. It is also noted that the majority of cases relate to small and medium enterprises. Companies with less than 20 employees represent some 83% of workers who have entitlements outstanding on insolvency. The proposed changes to the legislation will not apply to small companies and therefore may have minimal affect on claims under GEERS.

LIKELY CAUSES OF UNPAID ENTITLEMENTS

1. Lack of capital in small to medium companies, eg $2 capital companies.

2. Increases in redundancy liabilities arising out of negotiated salaries & wages agreements.

3. Lack of understanding by Directors as to cashflow needs, insolvency trading laws and the effect of insolvency on the reduced sale value of assets.

4. A growing trend to finance the operations of small to medium companies through off balance sheet items including 3rd party securities, factoring of Debtors and leasing of assets.

PROPOSED CHANGES TO LEGISLATION

The current proposed changes will put greater responsibility on Banks to ensure that employee entitlements are protected. This takes away the emphasis from the custodians of the business, i.e. the Directors, to be responsible for their actions. This appears contrary to Government policy and legislation which attempts to discourage directors from trading recklessly or whilst insolvent, which is a major issue in terms of the current debate with regard to corporate governance.

In small to medium businesses where assets provided as security to support loans are off balance sheet or are provided by 3rd parties, the effect of the proposed changes to the legislation may have little impact on protecting the entitlements of employees.

Also, due to administrative difficulties banks will encounter in dealing with their securities and in discharging their securities, lending practises will be changed to overcome the potential loss of security eg loans will be made to companies holding assets without employees. This will negate the effect of the proposed legislation.

OTHER ALTERNATIVES

The IPAA has supported both EESS and GEERS, and is sympathetic as to how to minimise the Commonwealth's exposure to such schemes.

We have observed that since the introduction of the insolvent trading provisions of the Corporations Act and the avenue available for directors to appoint voluntary administrators, directors are not risking trading on insolvent companies to the extent they were previously. However, when companies are traded on whilst insolvent, employees as a class of creditor are usually unlikely to want a liquidator to pursue a claim against directors for insolvent trading. The reason is that they do not wish the liquidator to risk their entitlements further by any costs associated with the litigation. Also, such litigation against directors is at high risk, because directors of failed companies have usually few personal assets remaining to pursue.

In these cases, the insolvent trading provisions are not a sufficient deterrent to prevent directors from such actions. The proposed changes to the legislation also do not address the central issue of deterring directors from risking insolvent trading, which is one of the major reasons why entitlements remain unpaid.

Accordingly, rather than imposing the responsibility on the Government to protect entitlements and then seeking greater protection through the Maximum Priority rule, greater responsibility should be placed on directors to ensure that employees are protected. In this way, responsible directors will take steps to avoid breaching their duties by ensuring that basic employee claims are met. This may occur through having adequate capital, setting up sinking funds, or obtaining insurance or some other protection, which ensures that employee claims are safeguarded.

For the reasons outlined in this letter, the IPAA believes that the proposed changes will ultimately be ineffective in reducing the Commonwealth's exposure under GEERS. However, in the event that the legislation proceeds, we strongly recommend that the Commonwealth take an active role, as a priority creditor by subrogation, in providing funding support for pursuing claims for insolvent trading to ensure that Directors are held more accountable for their actions. Such support will assist in setting an example within the business community, which in itself will be a deterrent against such behaviour by directors.

Yours sincerely,

Michael Dwyer
National President

bcc:

Steve Parberry
Hugh Parsons

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Appendix 2

Insolvency Practitioners Association of Australia
ACN 002 472 362

National Office
37 York Street
GPO Box 3921
Sydney NSW 2001
DX 1257 Sydney
Telephone
(02) 9290 5700
Facsimile
(02) 9290 2820

Ms Erica Gray
Regulatory Policy Branch
Australian Securities & Investments Commission
GPO Box 9827
Sydney NSW 2001

Our ref Ltr ASIC 041202

Contact Michael Dwyer, 08 8236 3165

4 December 2002

Dear Ms Gray

Financial reporting and AGM obligation for companies in external administration under Part 5.3A

We refer to ASIC's request for submissions in relation to the above discussion paper.

The IPAA supports all the views raised in KPMG's submission dated 28 October 2002.

Additionally, we believe it is imperative that given the significant issues involved, our industry be consulted with a further amended version of the discussion paper prior to the matter being finalised. Your acknowledgement that this course of action is feasible would be appreciated.

Yours sincerely

Michael Dwyer
President

bcc: Hugh Parsons

COPY

KPMG

COPY

KPMG Corporate Recovery

ABN: 51 194 660 183

KPMG
181 Collins Street
Melbourne VIC 3000
Australia

GPO Box 2291U
Melbourne VIC 3001
Australia

Telephone: (03) 9288 5555
Facsimile: (03) 9286 8886
Internet: www.kpmg.com.au

Our ref 008NAT001.004.008

Contact Ms Kim Arnold, 02 9335 8270

Ms Erica Gray
Regulatory Policy Branch
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001

28 October 2002

Dear Ms Gray

Financial reporting and AGM obligations of companies in administration

We refer to ASIC's request for submissions in relation to the discussion paper entitled Financial reporting and AGM obligations for companies in external administration under Part 5.3A. We appreciate the opportunity to respond.

We believe that the pursuit of greater transparency is worthwhile, however, we have the following comments to make in respect of the proposals put forward and the specific questions as noted in the discussion paper.

Questions raised in the discussion paper

Q1.1 Yes, additional guidance on the obligations of companies in controllership and liquidation would be useful.

Q1.2 Amendments to the law would only be required where ASIC does not have the power to suspend the requirements for compliance with financial reporting and AGM obligations for all companies in external administration. We are of the view that it is preferable for ASIC to retain discretion to grant relief, rather than have a prescriptive requirement in the Corporations Act.

Q1.3 The law should allow ASIC the power to grant relief. In most cases, relief should be granted to suspend the financial reporting and AGM obligations for companies in external administration.

Q2.1 At the moment the requirements to comply with financial reporting requirements for a company in receivership remain with the directors. We see no need to amend this, although we note that in many cases the directors may not have the financial capacity to comply with the requirements. If an amendment is made by ASIC, it should not cause the obligation for compliance to fall to the receiver.

KPMG, KPMG, an Australian partnership, is a member of KPMG International, a Swiss Association

Q2.2 At the moment the requirements to comply with AGM requirements for a company in receivership remain with the directors. We see no need to amend this although we note that in many cases the directors may not have the financial capacity to comply with the requirements. If an amendment is made by ASIC, it should not cause the obligation for compliance to fall to the receiver.

Q2.3 The terminology used in Policy Statements 43 and 44 should be changed to align it with the terminology now used in the Corporations Act.

Q3.1 Although the additional disclosures may mean that the accounts are no longer misleading (ie there is disclosure of the administration), we query the accuracy and relevance of the information and note that the compilation of this additional information will impose an unreasonable burden on the administrator. Furthermore the timeframe available is limited even with the six month extension, as illustrated by the following example:

An administrator is appointed to a disclosing company with an end of financial year date of 30 June 2002, on 2 July 2002. In the ordinary course of events, the company would have been required to lodged its accounts with ASIC on 30 September 2002 and report to members by 30 October 2002. However, due to the appointment of the administrator, these tasks now have to be undertaken by 2 January 2003 (under the ASIC proposal). It could be expected that with all the tasks facing an administrator (including holding creditors meetings, an adjournment of the second meeting, management of the business, efforts to sell or restructure the business, preparation of reports to creditors and negotiation of the terms of a Deed), the administrator will generally require all the time available in order to meet his/her existing obligations. If the proposed financial reports were to be signed (as the proposal requires) by 27 December 2002, then the earliest date that the financial reports can be made up to is 27 October 2002. Accordingly, along with all the other administrative and statutory obligations under Part 5.3A, the administrator now also has to arrange for financial accounts for the end of the financial year to be prepared, including supplementary information for the period from 30 June 2002 to 27 October 2002, and for all of this information to be audited. Considering the state of the financial records of many of the companies that are placed in external administration, this would be an onerous obligation.

We also suggest that most companies that are affected by the proposed class order will be large companies, and we note that it is quite common for the administrators of large companies (with complex operations) to seek and obtain an extension of the convening period or an adjournment of the second meeting. The additional tasks that this entails means that the available time for complying with the proposed class order will be further eroded.

Q3.2 Yes, we agree that compliance is not inappropriate, however this is by no means the main concern. Our most significant concerns relate to the unreasonable burden that this may entail, as discussed in greater detail at Q3.6.

Q3.3 Yes, compliance as suggested in the ASIC paper will impose an unreasonable burden in many cases. It is our opinion that imposing financial reporting obligations on an administrator at any stage where the company is in voluntary administration is an unreasonable burden. Similarly, it would also be an unreasonable burden in many cases where a company is subject to a Deed of Company Arrangement. Our reasons are given in greater detail at Q3.6.

Q3.4 Yes, relief should be granted in all cases, however, we disagree with the six month timeframe, as discussed in greater detail at Q3.5.

Q3.5 Six months is an arbitrary figure that may be suitable for some companies and not for others. As stated previously, we suggest that most companies that are affected by the proposed class order will be large companies, and it would be reasonable to assume that for most large companies there will either be an extension of the convening period or an adjournment of the second meeting, resulting in the second meeting not being held until substantially later than the standard five weeks. In fact there have been instances where the voluntary administration has continued for a period in excess of six months (Harris Scarfe Holdings Ltd). There should be no requirement to comply with financial reporting obligations during the administration period as a decision has not yet been made by the creditors about the future of the company. It may be that the company is placed into liquidation and relief is automatically granted. This will ensure that the voluntary administrator is not distracted by having to commence the preparation of financial reports at a time when it is still unclear as to whether the company will continue or not.

Q3.6 We agree that companies given relief should be required to lodge the section 439A report and receipts and payments (if the Deed requires receipts and payments to be prepared) with ASIC. However, we disagree that this information should be distributed to members by the administrator.

The principle reason for our disagreement is cost. A company is in administration because it is insolvent and thus has limited financial resources. It is normal that creditors are not going to be paid in full – even before taking into account the cost of sending large amounts of information to members. Accordingly, we do not believe that creditors (or in the event that there are such minimal funds available – the administrator) should bear the cost of providing information to members.

To demonstrate the level of costs that would be involved, we consider specific examples below. The average section 439A report, particularly for a larger company, is unlikely to be less than 20 pages.

Company	Number of shareholders	Number of photocopies		
		20 page report	30 page report	40 page report
Pasminco Ltd	46,000	920,000	1,380,000	1,840,000
Harris Scarfe Holdings Ltd	13,000	260,000	390,000	520,000
Centaur Mining & Exploration Ltd	7,500	150,000	225,000	300,000

In the case of Pasminco, if the report was 40 pages and photocopying costs were 20 cents per page, the copying costs alone would exceed $360,000. The postage to send an A4 envelope starts at around one dollar, therefore postage costs will exceed $46,000. There would, of course, be significant further costs in collating and distributing the reports and dealing with the inevitable return of undeliverable mail. Accordingly, in this example the creditors would have been at least $400,000 worse off, if required to communicate with a group of stakeholders who have no financial interest in the company at that point in time. It is up to the creditors to determine the outcome for the company – members have no say until such time as creditors are paid/satisfied or the administration comes to an end.

If the information must be made available to members and other stakeholders, we see several alternatives that do not require physical production and distribution of documents:

- The administrator could place a copy of the documents on his/her firm's website where they could be downloaded by interested parties;
- The administrator could place a copy of the documents on the company's website where they could be downloaded by interested parties; or
- ASIC could place a copy of the documents on their website where they could be downloaded by interested parties. This is our preferred alternative as it may be simpler for stakeholders to refer to the ASIC website, rather than identifying the relevant administrator and then locating their website (if they have one). In addition, the administrator may not have the funds (or requirement) to maintain the company's website.

Q3.7 Refer Q3.6.

Q3.8 Refer Q3.1. In addition, we have no objection to financial reports that are eventually lodged after the proposed relief expires containing additional useful information, however these reports should not be an obligation of the administrator or require creditors to incur additional costs.

Q3.9 The following factors should be taken into account when deciding whether to grant relief that extends beyond six months from the appointment of a voluntary administrator:

- Extensions of the convening period or adjournment of the second meeting which result in a long voluntary administration period;
- The terms of the Deed of Company Arrangement are such that the deed will finalise with the winding up of the company; or
- Additional costs will be imposed on creditors, in circumstances where members have no further financial interest in the company.

Q4.1 No, for the following reasons:

- There will be instances where a voluntary administration will continue for longer than seven months. In such cases the issues raised in paragraphs 4.6 and 4.7 will still apply.
- There will also be instances where the company has entered into a deed which will eventually end in the liquidation of the company. In such instances, there is no value for members in holding an AGM.
- The cost of holding the AGM is effectively borne by the creditors in situations where they are not being paid in full.

Q4.2 Yes, as long as the granting of the relief is automatically tied to the relief from financial reporting obligations such that if a company is not required to report financially, it will not be required to hold an AGM.

Other issues

- At paragraph 1.21 the discussion paper states that the voluntary administrator may remove and replace directors who fail to co-operate with the voluntary administrator, to ensure that the company complies with the financial reporting and AGM obligations. It is our opinion, that in practice it would be very difficult to find replacement directors for a company that is

in external administration and is insolvent or likely to become insolvent in the near future. Accordingly, this is generally not a realistic option for the administrator.

- At paragraph 1.22 to 1.24 the discussion paper discusses who is responsible for compliance in a Deed of Company Arrangement. Where the terms of the Deed of Company Arrangement are such that the deed administrator does not have the power to cause compliance with financial reporting obligations, the deed administrator should not be held responsible for compliance.

- It may be difficult and costly for a company subject to external administration to comply with a requirement to have the financial reports audited, particularly in light of the currently litigious environment and insurance difficulties. Furthermore, it is likely that the audit report will be heavily qualified and thus of limited use.

- The quality of financial information available to administrators is often very poor. We suggest that administrators would be very reluctant to sign off on a set of financial statements relating to the period prior to his/her appointment, that have been prepared from this information. In some instances, the financial records may be so poor that it is impossible to prepare meaningful financial statements.

- The Courts are currently exercising their power under section 447A to make orders waiving administrator's (and liquidator's, where the liquidation follows an administration) obligations to comply with certain statutory requirements (ie. Ansett – notices to creditors). This supports our view that the position for administrators with respect to lodging financial reports and holding AGMs should not be totally prescriptive. There should be an ability to waive the obligation in appropriate circumstances.

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Due to the large number of issues we have raised in respect of the discussion paper, we request that once the discussion paper is amended, it is again released for comment before it is finalised.

Yours sincerely

C M Nicol
Managing Partner, Corporate Recovery