To the Senate Inquiry into Liquidators and Administrators

From Michael J Mumford, International Centre for Research in Accounting
University of Lancaster, Lancaster, England LA1 4DD

27 January 2010

I am a Research Fellow at ICRA, University of Lancaster, England, and I have been researching corporate insolvency for some 15 years in conjunction with Alan Katz, who is a retired insolvency partner with Arthur Andersen's UK practice (and still serves as moderator of the Joint Insolvency Examinations Board in the UK).
We have conducted six research projects, both of an empirical and a theoretical nature, for the Insolvency Service, London, and for the Institute of Chartered Accountants in England and Wales.

Unlike Alan, I am not and never have been an insolvency practitioner, but I am a Fellow of the Association of Chartered Certified Accountants (and a former member of its Council and its Appeals Committee), and I have taught and researched accounting and finance at Lancaster University Management School since 1972.

I have read, with great interest, press comments (for example in Sydney Morning Herald 16-17 January 2010) about the claimed need for further changes to the law on corporate insolvency in Australia, in particular following reported suspension of Stuart Ariff as an insolvency practitioner. From the reported comments in the press, the following observations would seem warranted:

1. Ariff appeared to have taken several appointments even whilst his fitness to practice was being questioned, and possibly even subject to complaint to his regulatory body. Whilst this is not contrary to regulations, it suggests that any dilatoriness on the part of the ASIC is a matter for regret. But it is more likely that the problem lies in enforcement rather than defective regulations.
2. To an interested UK observer, the regulation of corporate insolvency in Australia appears well-based and thorough. There are an adequate number of practitioners in a competitive market of 576 practitioners, which is well-informed about the reputation of those practitioners. (Note that there are only about 800 appointment takers in the UK, with a somewhat larger number of registered companies.)
3. Indeed, in a forthcoming monograph (Mumford and Katz "Making Creditor Protection Effective", London, ICAEW), Alan Katz and I acknowledge that Australia leads practice in some important respects, notably the emphasis on solvency certification in creditor protection, and (more relevant in the present context) the active role played by ASIC in supporting insolvency practitioners and creditors in investigating and (where appropriate) prosecuting malfeasance by directors and others.

(continued…)

(continued…)

4. It is beyond doubt that insolvency practitioners face severe problems of moral hazard. They must establish, in any new appointment, whether the company has assets at risk, the scale of liabilities claimed and the nature of charges held, whether to continue to trade the company or parts of its business, and how far to deal with the existing board as responsible and cooperative rather than suspect and dishonest. Moreover, these judgements must be made, typically, very rapidly. Furthermore, it is largely up to the insolvency practitioner to decide what resources are needed to pursue the several commercial and regulatory tasks confronted, At the same time, their own remuneration and expenses are themselves largely dependent on these decisions, subject to review by the Court, creditors' committee, and (on complaint) the relevant regulatory body. It is important that these latter checks are exercised in a timely and effective manner, even though this has significant resource implications. It is costly to maintain teams of competent monitors.
5. It is also highly probable that failing corporations involve criminal activity at least as often as continuing enterprises do. It sometimes arises from theft, fraud and other forms of misfeasance, although the majority of cases (at least, in the UK) arise from misfortune rather than wilful negligence or worse. This tends to add to the considerable - and unavoidable - pressures on insolvency practitioners, the great majority of whom appear to us to perform their duties with skill and integrity.
6. In Australia, as in the UK, there are support systems (particularly in the banks) to aid the recovery of companies that are in financial stress, even though the performance of banks has been heavily criticised over the last two years after the credit crash. What this means is that companies that go into a formal insolvency procedure (receivership or administration) are usually the most hopeless cases, with the poorest prospects of recovery. This is important in making international comparisons of survival rates and of the relative size of insolvency practitioners' costs in relation to available assets.

I urge the Senate to reflect with great care before making further changes to insolvency regulation in Australia.

I stress, in conclusion, that I have no personal stake in the insolvency profession; I have some expertise in economics, law, accountancy and finance, but my comments are made as an observer who has studied corporate insolvency in some detail but always from a dispassionate and objective viewpoint.