COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**Reference: Australia's insolvency laws**

FRIDAY, 8 AUGUST 2003

MELBOURNE

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**JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES**

**Friday, 8 August 2003**

**Members:** Senator Chapman *(Chair)*, Senator Wong *(Deputy Chair)*, Senators Brandis, Conroy and Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

**Senators and members in attendance:** Senator Chapman, Mr Griffin and Mr McArthur

**Terms of reference for the inquiry:**

To inquire into and report on:

The operation of Australia's insolvency and voluntary administration laws, including:

(a) the appointment, removal and functions of administrators and liquidators;

(b) the duties of directors;

(c) the rights of creditors;

(d) the cost of external administrations;

(e) the treatment of employee entitlements;

(f) the reporting and consequences of suspected breaches of the *Corporations Act 2001*;

(g) compliance with, and effectiveness of, deeds of company arrangement; and

(h) whether special provision should be made regarding the use of phoenix companies.

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**Committee met at 9.37 a.m.**

**SMITH, Mr Stephen Thomas, Director, National Industrial Relations, Australian Industry Group**

**CHAIRMAN**—Welcome. Today the committee continues public hearings for its inquiry into Australia's insolvency laws. All witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege. I also wish to state that unless the committee should decide otherwise, this is a public hearing and, as such, all members of the public are welcome to attend. The committee prefers that all evidence be given in public. If at any stage of your evidence or answers to questions you wish to respond in private, you may request that of the committee and the committee will consider such a request to move in camera. We have before us a written submission from the Australian Industry Group which we have numbered 38. Are there any alterations or additions you want to make to the specific written submission at this stage?

**Mr Smith**—No.

**CHAIRMAN**—I ask you to make an opening statement, at the conclusion of which I am sure we will have questions.

**Mr Smith**—Thank you. The Australian Industry Group welcomes the opportunity to appear before the committee in this inquiry. We wish to generally limit our comments today to matters relating to the protection of employee entitlements, given that my area of expertise within the organisation is industrial relations matters rather than insolvency laws in particular. The Australian Industry Group has been heavily involved in the public debate about the most appropriate means of protecting employees' entitlements. Our members have endured a lengthy campaign over the past five years by the manufacturing unions, particularly the AMWU, to establish what we believe is a flawed and discredited trust fund which was formerly called Manusafe and more recently has been renamed NEST, the National Entitlements Security Trust.

Currently our members are once again being targeted with industrial action over this issue, particularly in the automotive sector and particularly in Victoria. Some 1,100 enterprise agreements expired in the manufacturing sector over the past five months. The AMWU has used this opportunity to make a further concerted effort to establish NEST. Fortunately, despite the issue being at the top of the union's list of claims for this bargaining round, the AMWU has failed to make any inroads into convincing employers to support this trust fund. It is highly unlikely that this situation will change because the majority of those agreements have now been settled.

Ai Group strongly supports GEERS. In the last financial year, as we understand it, the scheme paid out approximately $85 million to employees who would otherwise have lost their entitlements. Of course, that scheme does not operate in isolation. There are strong laws and other arrangements in place to ensure that all employers take responsibility for the protection of

their own employees' entitlements. These other laws and arrangements secure the entitlements of employees in 99.9 per cent of cases. GEERS provides an effective safety net for the remaining one-tenth of one per cent of cases where employees would have lost entitlements upon insolvency.

Numerous alternatives to GEERS have been suggested by various parties. Australian Industry Group has spent a great deal of time over the past five years considering different schemes which have been proposed and discussing them with those who are advocating them. In doing so, we have become even more convinced that GEERS is the best solution. We believe that all of the alternatives that have been proposed—those that we have seen—would create more problems than they would solve. GEERS represents an appropriate balance between all of the competing issues.

We are also of the view that the ongoing debate about whether or not GEERS is adequate is highly counterproductive. It heightens fears amongst employees about the security of their entitlements and it fuels further disputation about this issue in workplaces—workplaces, in the vast majority of cases, where the employees' entitlements are not at risk. The unions are using these fears and so on to once again seek to establish these trust funds that we believe are highly inappropriate and not the effective solution to the issue of protection of employee entitlements.

There is only one change we are seeking to GEERS. Now that the scheme has been in operation for nearly two years, we believe that there would be great benefit in having that scheme enshrined within legislation. This would negate consistent union criticism that the scheme is administrative in nature and could be modified at any time. If such legislation were introduced into parliament by the federal government, we can think of no valid reason why all political parties would not support it as such a measure would further enhance protection for employees' entitlements. We have expressed that view now to all of the political parties.

With regard to the federal government's maximum priority rule proposal, we would have to say that we were initially very sceptical about the protestations of the banks and the dire consequences which they predicted would occur if such a change was made. However, we have taken the time to look at that issue in some depth. In doing that we have consulted with our members and we have had some relatively detailed discussions with the banks about the issue. We are now convinced that that proposal would significantly disadvantage both employers and employees. Companies experiencing financial pressures would be most affected by the proposal and almost certainly finance would be much harder for struggling companies to obtain. It is quite logical that that proposal, if it proceeds, would lead to an increase in the number of insolvencies because of that very fact. In conclusion, we believe that the existing laws and other arrangements in place to protect employee entitlements in Australia are fair and balanced and are operating effectively.

**CHAIRMAN**—Thank you, Mr Smith. I note from your submission that you are opposed to the maximum priority proposal. Does that proposal have any merits at all or is it completely a downside in terms of AIG's attitude to it?

**Mr Smith**—We are aware of the background to the introduction of the proposal in terms of when it was announced and so on. The Prime Minister announced the proposal, as we recall it, at the same time that he announced improving the EESS to the level that is now provided within

GEERS. As we understand the government's position, the two issues were linked. In simplistic terms, when they look at it many people would say, 'It's a fair and reasonable proposal.' But when we dig down and have a look at the impact of the proposal, we have significant concerns about it. As we have set out in our submission, it will have a more negative impact in some sectors and, as I have said, in circumstances where companies are struggling. Those are the very circumstances in which finance needs to be available.

**CHAIRMAN**—How do you respond to the view put by the Australian Workers Union that employees have more at stake than others in that not only do they have their entitlements at stake but also they are losing their job in an insolvent situation and employees, unlike perhaps banks and other suppliers to a firm, are not able to build a risk premium into their wage conditions?

**Mr Smith**—It is an argument that most people can understand. There is a lot more sympathy for employees and the loss of entitlements by employees than there is for banks and the loss of funds by banks. The problem is, as I have said, if you do not deal with that issue in an effective way all it means is that the employees are not in a position to continue in employment because their company will go out of business—in some cases in circumstances where that company could have continued to operate. The words that we have highlighted in our submission out of a 2000 Productivity Commission report are very valid. The Productivity Commission highlights that this sort of a change is not a change that you would want to make lightly because there are many ramifications. As we understand it, this is a very unusual positioning of different interests, when you look at comparable schemes overseas.

**CHAIRMAN**—The Cole royal commission has made a number of recommendations in relation to fraudulent phoenix companies. I do not know whether you are aware of that issue in terms of the Cole royal commission.

**Mr Smith**—Yes.

**CHAIRMAN**—Are you able to make some comment on the incidence of phoenix companies and the effect they have, and in particular the proposal by the ATO in submission to this inquiry that a person who has been a director of a company which goes bankrupt on two or three occasions should be in effect permanently disqualified from being a company director in the future?

**Mr Smith**—The Australian Industry Group was extensively involved in the royal commission. We were the only organisation that presented a submission on every one of the discussion papers put out by the royal commission and we put in three comprehensive submissions. We have thoroughly analysed the final report and produced a 150-page response. That response paper does contain a section on these phoenix company proposals. I would be happy to forward a copy of that section, or the whole submission, if the committee wants it.

The line that we look in that part of the submission was to say that we believe that the royal commission's proposals have merit and that we support the idea in principle that laws should be changed in this area and toughened, given the evidence that was before the royal commission and the findings of the royal commission about phoenix companies. But we also made a strong point that you need to get the balance right because, if it is not struck at an appropriate level, it will have a negative impact on entrepreneurship and risk taking. It would be unfair to seriously

disadvantage owners of businesses who legitimately put up their own capital and go broke, normally at great hardship to that individual. Everyone would agree, I think, that it needs to be struck at an appropriate level. In short, what we have said about those proposals is that we support the basket of them in principle but we believe they need to be looked at in great detail in drafting them into legislation.

**Mr McARTHUR**—You mentioned in your opening remarks that when you had further discussions with the banks your group was more inclined to the view that the banks had a sensible point of view in the availability of credit to small business. Could you just help us as to why you changed your position somewhat on that fundamental issue?

**Mr Smith**—When we started the process of consultation with the banking industry, we had not formulated a position in particular. We were just sceptical because, obviously, the banking industry has a particular interest with this issue. It is necessary to look at the issue in a fair way. We discussed the issue with the banks and we understand the way that the average bank deals with its lending criteria. It has different gradings of lender. There might be eight or 10 different gradings. A company that has many assets and a lot of liquidity and so on might be a No. 1 and another that is really struggling might be down at No. 8 or No. 10. In terms of the way we believe this proposal would operate, a company in those lower few bands of risk—one that is at high risk of defaulting, if you like—will either be unable to obtain finance under this proposal or will not be able to obtain finance at reasonable rates. We talked about—

**Mr McARTHUR**—Is this because of the risk of the accumulated worker entitlements?

**Mr Smith**—It is not so much that. As we understand the position, a bank would lend money to a company if there was some asset that it could secure that money over—a factory, plant and equipment and so on—whereas if employee entitlements were moved ahead of that security then the bank would have no security, in a sense, for its money and is unlikely to lend—

**Mr McARTHUR**—What is your position now, then? Are you supporting worker entitlements ahead of the bank security?

**Mr Smith**—No, we are not. We support leaving the issue as it is. It is obvious that publicly a union and many other parties would take the position that employee entitlements of course should be moved ahead of banks. It is a position that the average member of the public would understand. But I think those within the union movement that have really thought about this issue and analysed this issue would be worried about it as well—that is a view that we have—because of this impact. We see that in some sectors, such as textile, clothing and footwear, there seems to be a reluctance to lend to companies in some sectors to the same extent that there might be finance available in other sectors. Those are the sorts of sectors and the sorts of companies that are really going to be negatively impacted upon by this proposal.

**Mr McARTHUR**—From the employees' point of view, if you are arguing this case, what is to their advantage?

**Mr Smith**—It is to their disadvantage if they lose their job, of course, because the company is insolvent.

**Mr McARTHUR**—Okay. You would argue the public case that the unavailability of credit would make the job probably not available or lost relative to the payment of employee entitlements. Is that what you are arguing?

**Mr Smith**—The employee entitlements are covered to the level of GEERS. We see this proposal in one sense as being driven by the government to move GEERS to the top of the queue. I do not think the government has been frightened to say that. That would be the effect of it. GEERS pays out the moneys to employees. GEERS then is placed at the top of the queue and the taxpayer recoups more money than it would have done under the existing arrangements. But the vast majority of companies that are going into insolvency are small businesses. As we understand the proposal, it still proposes to carve out small businesses. So a lot of those companies that would have been affected by this are carved out anyway. We question, with all the risks involved, whether the proposal has sufficient merit to take those risks.

**Mr McARTHUR**—Do you think the payments quarterly will assist in that? At least the liability would be known and there would be only one quarter that would be in arrears.

**Mr Smith**—This is the superannuation proposal you are talking about now?

**Mr McARTHUR**—The superannuation proposal particularly.

**Mr Smith**—Yes. We certainly think that will help. We supported the superannuation proposal to move to quarterly requirements in that area.

**CHAIRMAN**—Should superannuation be included within GEERS or not?

**Mr Smith**—We do not think it is necessary to do that because this change to quarterly contributions has only just been introduced—from 1 July, if I recall correctly. We should, we believe, allow that to operate and see what impact that change has. That change was made principally to increase the security of employees' entitlements. It has just been introduced, so we believe it should be given time to operate.

**CHAIRMAN**—Can I ask your attitude to the potential impact of deeds of company arrangement on GEERS entitlements? We had some evidence yesterday from witnesses who had been unable to obtain access to their GEERS entitlement because of the way a deed of company arrangement was drafted, which effectively prevented the Commonwealth standing in the shoes of the creditor to eventually obtain a share of whatever was realised from the insolvent company.

**Mr Smith**—We have not had any experiences that have been brought to our attention in that area, so I could not make an educated comment about it, sorry.

**Mr McARTHUR**—Could I raise the issue of eight weeks being the recognised community standard for redundancy and your suggestion that those companies in heavily unionised work forces tended to have greater redundancy provisions? Would you like to add to that point of view?

**Mr Smith**—It is certainly the case in sectors such as manufacturing that a lot of companies have much more generous redundancy provisions. Three weeks per year of service, for example,

is not uncommon in the manufacturing sector amongst big unionised workplaces. But for every one of those companies you could find nine or 10 other companies that are paying the eight-week standard. As we highlight in our submission, there are enormous difficulties associated with any protection of entitlement scheme that purports to go beyond the acceptable community standard. How would it operate effectively? You could not allow a situation, of course, where a company could agree to very generous redundancy entitlements within its enterprise agreement only then to have the taxpayer pick up the tab if that company went broke. It might be one or two years pay for some employees. Another circumstance would be where the company is just paying under the award and that other employee would only get eight weeks pay. It would be like an unemployment benefit scheme that pays an out-of-work CEO hundreds of thousands of dollars a year and an out-of-work labourer a tenth or so of that amount.

We have looked at this issue in great depth over the last five years. We have been involved in numerous forums where we have debated the issue—before the Productivity Commission, for example, in the auto inquiry and the textile inquiry with our members who have been targeted with industrial action. We cannot see any sense in having a protection of entitlements scheme that does not stop at the community standard.

There is a case going on today in fact—the redundancy test case—where the unions are pushing for that standard to be increased to up to 20 weeks. We are opposing that. If, when the decision is finally handed down at the end of this year or early next year, that standard increases from eight weeks, there will be a very good argument why GEERS then should reflect the current standard, but the standard at the moment is eight weeks.

**Mr McARTHUR**—Are you aware of view of some commentators that the US steel industry has great difficulty because of the payment of redundancies and it is almost impossible to shed the work force because of redundancy payments?

**Mr Smith**—Yes. We see that every day. We see that excessive redundancy payments in Australia, in fact, are driving casualisation of the work force. People are reluctant to take full-time employees on unless they are sure that they need people. There is a witness who is appearing for us in the redundancy test case who had a textile business. This company was in financial difficulty. The company had entered into some arrangements with its creditors. There was a viable proposition on the table to keep the company in operation, but the relevant union and the employees wanted the very generous redundancy package, rather than keep the company going. The witness statement is already before the full bench in the redundancy test case. That is a glaring example of the problems of excessive redundancy packages.

**Mr McARTHUR**—Thank you, Mr Chairman.

**Mr GRIFFIN**—We might leave that to the courts to discover, I suppose.

**Mr Smith**—If you would like me to make that detail available to the committee, I would be happy to do that.

**Mr GRIFFIN**—The point I am getting at is that until you hear the other side of the argument about the actual nature of that business, it is a bit much. You can make a statement about it, but essentially we cannot really review that here.

**Mr Smith**—Yes. I am sure that when Mr McGloin gets in the witness box the ACTU will have questions to ask him. That is entirely appropriate.

**CHAIRMAN**—Can I raise with you the proposition from the ACTU that employers should be required to regularly provide details in terms of financial statements to employees and unions as to the provisioning made for employee entitlements?

**Mr Smith**—It is a proposal that is already in operation in terms of public companies. That detail is there within their financial statements. They have to provide for annual leave and long service leave. The financial statements, of course, are audited and so on. We do not believe that the arrangement should extend any further than public companies in terms of the public release of that information, unless agreement is reached about that issue at the enterprise level. In many cases agreement has been reached about such issues. As I have said, there are a lot of agreements at the moment in the manufacturing sector that are being renegotiated, and protection of entitlements is an issue that is being dealt with. It is a key union claim. Some of those arrangements have resulted in companies agreeing to share information. Others have agreed to provide letters of comfort from the parent company and so on. But there is no one model that we believe should be imposed across the board, other than the very stringent arrangements that are already there.

**CHAIRMAN**—What is your attitude to the argument that that should extend also to contingent employee entitlements, as well as accrued entitlements?

**Mr Smith**—It is a misnomer to call redundancy an entitlement, we believe. Companies enter into these very generous redundancy arrangements in a lot of different sectors, such as manufacturing. They never expect that one day every single one of their employees is going to be paid out that amount of money. Once you say, 'That is an entitlement,' people then think that needs to be protected in some way. Look at the different options for protecting it. If the unions had their way, they would say, 'You should take all of that money and put it somewhere in a union controlled trust fund.' That is just an absolute nonsense. It is not an entitlement until the person is actually made redundant.

There are other instruments that unions seek to impose on companies, such as bank guarantees. So a company has to pay all of this money out every year for a bank guarantee to protect something that is not an entitlement unless they are actually made redundant. In most companies it will be only a small percentage of people that are ever made redundant.

**Mr McARTHUR**—What about the view that this increased redundancy is encouraging management to take a short-term view in an industrial dispute, so extended redundancies are given away to solve a short-term problem and they accumulate over time and then if the company does have a change in its work force that becomes a major impediment on the operation of the company? What is your assessment of that observation?

**Mr Smith**—Yes, I agree with that entirely. Many companies have unfortunately agreed to redundancy arrangements under industrial pressure and now they—

**Mr McARTHUR**—With a view that they will never have to pay them?

**Mr Smith**—With a view that they will never have to pay more than a handful of employees. Now they are faced with claims by unions to say that is everyone's entitlement, and in our view that is absolute nonsense. It is only an entitlement if you are made redundant. This whole agenda by unions to say that redundancy entitlements are entitlements in the usual sense and that they should be protected is very damaging. We have member companies at the moment which are experiencing industrial action as we speak over this very issue in Victoria. This view being perpetuated that redundancy is an entitlement is very damaging. It is not an entitlement; it is a contingency.

**Mr GRIFFIN**—I want to talk about generous redundancies. Your submission talks about eight weeks being a recognised community standard. There are examples at the more extreme end in certain industries in terms of size, but you are saying that is a community standard. Are you saying that the community standard of eight weeks is overly generous and over the top?

**Mr Smith**—No. We believe the standard eight weeks is appropriate, and that is a submission that we are putting to the redundancy—

**Mr GRIFFIN**—Yes, that is my point—there are some industries in some areas. I used to work as a union official in the oil industry, and there are huge redundancies in that area. It was the nature of a whole range of things that occurred in that industry. It was also a small industry. There were not many employees. In terms of actual impact along the lines that you are suggesting, it just was not an issue.

**Mr Smith**—In the manufacturing industry, more broadly in unionised areas, generous redundancy packages are relatively common. The oil industry and some other industries are very much at the top end, where four weeks per year of service without any ceiling is not uncommon. But we do see, as I have said, the impact of these things every day. Companies are reluctant to take on full-time staff. In the manufacturing sector the level of casualisation is still nine to 10 per cent, which is low compared to most other sectors, but we still see it every day with companies saying, 'We're not going to run the risk of putting on a full-time employee until we are sure that we need them because of these redundancy packages.' It is very hard to know what to do about that in terms of addressing the problem, but one thing that has come from the problem in the last two or three years is this perception that is being pursued by unions that that is an entitlement that needs to be protected, and that is one significant problem that we believe should just go away. When an issue is debated in a fair and proper way, we do not think there is any merit in an argument that that is everyone's entitlement and needs to be protected.

**CHAIRMAN**—In passing, you made reference to entitlements being set aside in trust funds and the like. I take it you do not support the CPA Australia suggestion that progressive provision for annual and long service leave, and also other designated employee entitlements, should be set aside in a trust fund?

**Mr Smith**—No, we certainly do not. We believe the existing arrangements which require that those entitlements be provided for, as set out in relevant accounting standards, is appropriate. This whole proposal of putting moneys aside into trust funds will have a significant negative impact on companies' cash flow. There are all sorts of taxation and other problems associated with it. We strongly oppose that idea.

**CHAIRMAN**—Are you surprised that CPA Australia has made that sort of recommendation, given that it generally acts as advisers to business?

**Mr Smith**—I have not seen its submission so I cannot comment, but it does seem like a very surprising thing for it to put. As I have said, for five years in the manufacturing sector business has fought a very flawed and discredited proposal by manufacturing unions to establish a trust fund. Even in this latest round of bargaining the unions are making no inroads at all on it, even when companies are faced with significant disputation, and that highlights the level of resistance to this whole concept.

We are supportive of the concept of trust funds in the construction sector, where people are moving from project to project and they do not have any relationship typically with one employer. There are schemes in that sector which exist for long service leave and severance that we accept and we are not suggesting that they should go, but in other sectors like manufacturing where there is ongoing employment we do not believe that is an appropriate model.

**CHAIRMAN**—Another suggestion has been made about insurance schemes protecting these entitlements. What is your attitude to that proposal?

**Mr Smith**—We have been involved in looking at this issue in some detail and we are aware of the position expressed by the Insurance Council of Australia a few years ago. In its view, it is not feasible to have an insurance scheme protecting entitlements in Australia. We have seen no more recent announcements from it after that public announcement on that issue. We have had several insurance brokers come to us with proposals for insurance schemes to protect employee entitlements, which we have looked at in depth. We are not convinced that there is any merit in that proposal at all.

There is also another important issue. If all companies are forced to insure for entitlements, even assuming for a moment that it just covered the entitlements that GEERS covers, so you have a consistent standard, you are then forcing successful companies to pay for the entitlements of employees of unsuccessful companies. That, in our view, is unfair. Why should a successful company that has done everything right and has protected the entitlements of its own employees pay the entitlements of some other company’s employees? That is just as unfair, in our view, as some other arguments that come from—

**Mr GRIFFIN**—What is your view on health insurance? Will health insurance basically be undermined with the community where healthy people and people who are more likely to be healthy are, to a large extent, paying for people who get sick?

**Mr Smith**—That is different because the people who are paying health insurance are those who are benefiting from the scheme, whereas this—

**Mr GRIFFIN**—Not if you are not making claims.

**Mr Smith**—But you are talking about the people who are actually benefiting receiving a benefit—

**Mr GRIFFIN**—If you are insured and you do not claim on your insurance, your benefit is there because you have the coverage but you are not cashing in on your benefit. That is the same thing that would happen with a company that was doing the right thing in the context of something like this, surely.

**Mr Smith**—We believe it is a legitimate thing for the taxpayer to fund. The business community pays its taxes. A significant percentage of the taxation that is collected comes from the business community. On all of the assessments that you see about the extent of lost entitlements in Australia, they range from about $60 million per year at the low end. Some assessments like the ACTU's assessments go up to a few hundred million. Whichever place it sits within those two ranges, we are still talking about a very small percentage of companies that become insolvent and leave their employees owed entitlements. Unions constantly talk about HIH, One.Tel and Ansett. The employees of HIH and One.Tel not only got every cent of their entitlements but also got entitlements that they did not even have when the company became insolvent. The Industrial Commission created new entitlements after the insolvency to give them retrospective redundancy entitlements that they did not even have.

In the case of HIH, it was three weeks per year of service. In the case of Ansett, the unions constantly point to the fact that the Ansett employees have lost their entitlements. As we understand it, the reason why Ansett employees have not received all of their very generous over-award severance pay at the moment is that different groups representing employees are still arguing about the hundreds of millions of dollars. The latest assessment that we saw from the insolvency practitioners was that they were still going to get about 90c in the dollar of a redundancy package that provided up to two years pay for each employee. There was a court case earlier this year which held that for some of those employees that ceiling of two years was invalid. A lot of the arguments about protection of entitlements, we believe, are based on false information that is being circulated.

**CHAIRMAN**—Health insurance is voluntary, too. It is not compulsory, whereas the proposal for these insurance schemes is to make them compulsory.

**Mr GRIFFIN**—We can go for some other insurance schemes if you like.

**Mr Smith**—There is no suggestion, as we analyse it, that GEERS is under any pressure at all. The scheme is there. It paid out, as we understand it, about $85 million last year, and that seems to be a sustainable and appropriate level of protection. That is why we support it.

**Mr McARTHUR**—You are suggesting the definition of 'small business' be changed in the Corporations Act. Could you enlighten the committee as to this very difficult problem of defining small business as you see it?

**Mr Smith**—Yes. This is a submission that links in with our understanding of what the government is looking at with this maximum priority rule proposal. When the Prime Minister announced that proposal back in September of 2001, and in the federal government's policy papers prior to the last election, it appeared to say the government was looking at carving out small business. There was a proposal that Treasury circulated about how that could be achieved, and we made submissions on that proposal.

We believe if you are going to carve out small business with that proposal you should really look at small business in a multidisciplined way. For example, a labour hire company with 50 employees is an extremely small company, but a company in the oil industry or the chemical industry with 50 employees is quite a big company because it is all very capital intensive. That is why we are suggesting that there be three different tests and if it meets any of those tests then it is a small business.

**Mr McARTHUR**—Have you run the ruler across a number of small businesses to see whether they meet your three-way test?

**Mr Smith**—It is easily done. Yes, we have in a simple way. These three tests come out of the Corporations Law at the moment, but where we suggest they should change is that the Corporations Law looks at these tests not in the way we are suggesting. We are saying if it meets any of those characteristics then it is a small business. Under the Corporations Law there is a different grouping of those arrangements.

**Mr McARTHUR**—Good luck to you.

**CHAIRMAN**—There are no further questions, Mr Smith. Thank you for your contribution to this inquiry.

[10.22 a.m.]

**GILLAM, Mr Trent, National Corporate Research Officer, Australian Workers Union**

**HEATH, Mr Colin, Secretary, TAPS Branch, Australian Workers Union**

**CHAIRMAN**—Welcome. The committee prefers that all evidence be given in public, but if at any stage of your evidence or answers to questions you wish to give evidence in private you may request that of the committee and the committee would consider such a request to move in camera. We have before us the written submission from the Australian Workers Union, which we have numbered 39. Are there any alterations or additions that you want to make to the specific written submission at this stage?

**Mr Gillam**—No.

**CHAIRMAN**—I invite you to make an opening statement, at the conclusion of which I am sure committee members will have some questions.

**Mr Gillam**—First of all, I would like to thank the committee for the opportunity to appear here today. The union's written submission obviously focused on items (d) and (e) of the inquiry's terms of reference, being those items relating to employee entitlements and the cost of external administration. The union's basic position is that in the first instance steps should be taken to prevent insolvency from occurring. The second point I would like to make is that the Australian accounting standard should be modified to require corporations to list contingent employee liabilities in their annual financial reports and, further, that the definition of 'insolvency' in the Corporations Act should preclude corporations from trading when net unsecured assets are less than the total value of the employee entitlements, including those contingent liabilities. Further, unions and employees should have the legislative right to access comprehensive financial information from corporations. Thirdly, the union considers that employee entitlements should be prioritised above all other creditors, including secured creditors. Fourthly, GEERS should remain as a safety net in this scheme but should be modified to include all employee entitlements, including all redundancy and superannuation payments. Fifthly, directors and company officers should be more accountable following corporate collapses. Finally, the cost of external administration should be monitored closely.

At this stage, I would like to talk more about the prioritising of employee entitlements and the GEERS scheme. As noted earlier, it is the AWU's general position that employee entitlements should rank above all creditors, except of course for administration costs and other approved court costs associated with the administration. In this context, 'employee entitlements' should be defined very broadly—all accrued entitlements, including long service leave as well as redundancy pay, in accordance with the relevant industrial instrument, and not just capped at eight weeks as it is currently under the GEERS scheme.

Basically, this stance is justified because the personal consequences for employees facing insolvency are extremely dire, especially compared to that of lenders and business creditors. Also, lenders in particular have very sophisticated risk assessment and monitoring abilities and

are able to factor risk more easily than employees individually and even more than employees represented by a union are able to. Further, lenders and creditors generally are able to extract risk premiums or are able to alter their terms of trade with businesses facing some sort of financial difficulty, whereas employees usually face the opposite situation where they are asked to reduce the amount of money that they receive in order to help the company through difficult times. While employees are glad to do that—they would rather have a job than not—ultimately if a company does become insolvent then they have lost additional money.

I would like to talk a little more about GEERS. While GEERS does provide a reasonable safety net for employees facing insolvency, the AWU believes it should be business, not the taxpayer, that should take primary responsibility for these sorts of entitlements. That said, if employee entitlements were elevated above those of secured creditors in the course of insolvency, it would be appropriate to leave the GEERS scheme in place to have that safety net in case even at that level there is insufficient funds to cover employee entitlements.

However, the AWU believes there remains deficiencies in the GEERS scheme and, in particular, that the GEERS scheme is limited to only eight weeks payment for redundancy. We are of the opinion that that should be broadened out to pay redundancy according to the relevant industrial instrument. Also, the union is of the view that GEERS payment should also cover unpaid superannuation entitlements. I will hand over to Colin, who has some issues he would like to talk about.

**Mr Heath**—I thought it would be useful for the committee to look at a specific example and one that is a consequence of direct government action which we think should be considered into the future and should be a relatively easy remedy. I have had members who were employed by AGTS, Australian Gas Technology Services, a company which collapsed in February and was liquidated soon thereafter. That company arose out of the privatisation of the Gas and Fuel Corporation back in 1999. It was a scientific services division of that company. It was a relatively small and minor component of the entire privatisation, but members of mine had an average length of service of around 22 years. The company collapsed and they lost all their entitlements.

It was only through the process of the liquidation that some facts emerged which we think should not be repeated. For instance, it is only through the process that we learnt the Kennett government discounted the sale of that business to offset the enormous employee entitlement liabilities. Even though the company itself had a book value of millions of dollars it was sold for nearly zero, firstly, to the Gas Association. It subsequently transferred it to four shareholders—four very large energy companies—that is, AGL, Envestra, Country Energy and Energex, and they all took shareholdings worth $3 each. The total capital invested by each owner was $3, or $12 altogether, and when it collapsed they lost their shareholding but our people lost up to $2 million of entitlements, including redundancy and superannuation.

The other consequence and important lesson is that because the company was privatised the government did not provide the enterprise with any ongoing contractual arrangements. There were agreements with distribution retail companies where a large amount of money was made. In privatisation we are not compelled to have any long-term arrangements with AGTS. It used to be an internal service provider. Obviously it was a recipe for disaster and that is exactly what happened. Certainly GEERS has played a role. It has delivered just less than half of what

employees would normally be entitled to. That is a standard of redundancy that exists throughout the public sector and other entitlements. They are still well short of what they believe they deserve for their long length of service and so forth.

We believe if governments, as legislators, are to privatise any of their respective arms of government, then quite clearly arrangements have to be made to secure the entitlements or quarantine them in such a way that the vagaries of private enterprise cannot rob long-serving ex-government employees of their life's accrued entitlements. That is quite clear and straightforward. Certainly I am alive to that issue now. It is an issue that we are aware of in the AWU, and any privatisation that we find ourselves in in the future—that is one of the issues we will be strongly pressing. My view is that it should not eventuate in the first place. I think any privatisation should be accompanied with some method of quarantining—at least to the point of departure—all entitlements. That is one of the issues I seek to draw to your attention today.

**CHAIRMAN**—To pick up first the AGTS circumstance that you have drawn to our attention, you said that in the process of the privatisation the sale price of the organisation was discounted heavily because of the accrued entitlements. Does that perhaps point to the fact that agreement to provide what might be regarded as overgenerous or very generous employee entitlements does in fact place a burden on a business in terms of its ongoing survival and perhaps its capacity to access capital, finance the interest rates it has to pay and the like?

**Mr Heath**—I do not believe that is of any truth at all. The entitlements, strangely enough, are lower than private sector entitlements. Certainly when our members were privatised, most of the private energy companies provided them with entitlements in excess of what they enjoyed in the public sector. Generally speaking, there is quite a range of public sector benefits that are, to some degree, at a discount given that they were a trade-off. It is perhaps an old-fashioned concept now, but certainly my members when they started their employment believed they had a job for life, and some of the additional benefits you find in the private sector that members enjoy now did not exist. So they bought a company knowing full well what the existing entitlements were at the time, and they were not at a premium to the private sector by any stretch.

**Mr GRIFFIN**—Could you run through what those entitlements were that were included in the discounting given to the new owners?

**Mr Heath**—As I say, it had a book value. I do not know the precise book value but it was billions of dollars. As I understand it, at the time of departure the sale price was $30,000. So it bought the company for $30,000.

**Mr GRIFFIN**—What I am saying is the entitlements that were—

**Mr Heath**—Accrued long service and annual leave, obviously, with an average length of service probably at the time of 20 years. There was a range, but that is the average for 40 people.

**Mr GRIFFIN**—And recovery of redundancy payment?

**Mr Heath**—And redundancy based on what was the less generous public sector standard of two weeks per year of service.

**Mr GRIFFIN**—So your understanding is that there was an allowance in the negotiation around the question of the price for the value of the total entitlements, which included the actual redundancy payments that they would have been entitled to if they all left at that time.

**Mr Heath**—That is right. That is what I am led to believe. Given that there was enormous liability, instead of transferring the money across, they just said they would take the price down to this.

**Mr GRIFFIN**—What would the redundancy payments in that industry at that time have been? There has been some talk by the previous witness about eight weeks being the community standard.

**Mr Heath**—It is well established. The energy industry standard is three weeks or three weeks plus in the private sector, and that has been long established in the major energy companies, but the public sector standard is less at two weeks per year of service.

**Mr GRIFFIN**—With a ceiling?

**Mr Heath**—Only in certain circumstances.

**Mr GRIFFIN**—Some of those employees, you were saying, worked for the company for 20 years. For some of them there would have been something like 40-weeks worth of redundancy payments included in that liability that was used to discount the actual price of the operation.

**Mr Heath**—That is right.

**Mr GRIFFIN**—Which flies in the face of the evidence of the previous witness on the nature of these things. His view was that these things should not be included in the value of—

**Mr Heath**—I think you can understand the nature of the public sector. When these people started out, they spent long worthwhile careers with one employer. These are highly trained people. Most of them are scientists. In fact, Gas and Fuel Corporation was one of the leading gas technology research development companies in the world at one stage.

**Mr GRIFFIN**—The point I was getting at, to spell it out, was that the previous witness was basically saying that redundancy payments as such should not be included in effect as entitlements. Yet your example shows that there is a case with privatisation where they were included as entitlements and were valued as entitlements, which goes against what he was suggesting.

**CHAIRMAN**—Tying it to financial statements.

**Mr GRIFFIN**—Well, no, he was in effect saying that you should not put companies in a position where they make a provision for the payment of redundancy payments, and this is an example where as part of the process of a sale there was a provision made for the value of the redundancy payments as they stood at that stage. I just want to make that point.

**CHAIRMAN**—Can I just clarify that? In this provision that you say was made, were the potential redundancy entitlements included or simply the accrued entitlements to long service, annual leave and so on?

**Mr Heath**—The redundancy was well established. I think the figures bear it out. Gas and Fuel had downsized from 6,500 employees at the time of privatisation to under 1,000. All had benefits from that redundancy. In fact, the redundancy was established many years before that. There had been huge reductions. At every stage, restructuring had occurred with that redundancy package. It was understood that, if people departed and there was further restructuring—there was a small number departed after the company was established—yes, that would be the benefit they would enjoy.

**Mr McARTHUR**—A previous witness suggested that the redundancy payments to the Ansett employees were very generous. What would your comment be to that—that the redundancy would be paid to all employees, not just a section of the work force?

**Mr Heath**—I am not familiar with the level of the Ansett redundancy. But once again, I would say those people would find themselves in a similar situation: these redundancy arrangements were well established and the workplace had been used to restructure. I know, because I have been an official looking after gas employees for nearly 20 years now, that in fact there were any number of trade-offs reached in agreements to allow for the establishment of a redundancy. That was taken into account in a range of decisions we took.

**Mr McARTHUR**—As I recall, the comment by the previous witness was that the industry average was eight weeks and there was something like two years redundancy for Ansett employees. That seems fairly generous to me.

**Mr Heath**—It would have been up to two years, depending on how long they had worked there. As I say, I would assume that, if you were an Ansett employee and you had dedicated a lifetime of employment to that particular company, and you had stayed there and put up with all of the restructuring through that time and accrued long service and benefits that go with it, you would expect that when the worst scenario occurred you would be able to rely on that. During a lifetime of employment there is a range of decisions we make as officials and employees to actually build in those securities. That is the way I would categorise it.

**Mr GRIFFIN**—In your experience around the question of when companies are being sold off to other companies—not only in terms of privatisation but if you had had an experience of companies being on-sold et cetera—how do they handle the issue of employee entitlements as part of working out a sale price and so on? Is there any sort of community standard or manner in which that is normally negotiated? What I am getting at is: are things such as potential redundancy payments for staff that have been picked up through taking over another company as they stand at that time included in the negotiations?

**Mr Heath**—That is certainly my experience. I have been involved in the Bradmill receivership. I do not know whether you are aware of Bradmill. It is in Footscray. It could have fallen over completely. There was significant cooperation from both state and federal governments to assist that company. But clearly the end result was a significant restructuring. They lost about 600-odd employees and they have got about 350 left. Part of that whole process

involved those people departing with their entitlements. Once again, these were long-serving employees who had spent their whole lifetime working for a particular company. They had their entitlements, which were more generous than—

**Mr McARTHUR**—What was the redundancy in that case?

**Mr Heath**—They had a standard of 2½ weeks per year of service. That was certainly taken into account in the finalisation of the restructuring and the ongoing employment for those who remained.

**Mr GRIFFIN**—The point I am trying to get at is that the previous witness was basically saying that you should not count the potential costs of redundancy payments before you start. He is saying that it is an unfunded liability, but it is not a liability because it may never be realised, so you should not—

**Mr Heath**—It is ignoring reality. Redundancy is an extremely well understood concept now. I remember that when we started out unions had a view that you did not talk about redundancy. We did not seek to include it in agreements. We hoped it would go away. But it did not go away. We were forced to embrace it and recognise it as a reality. Companies have a right to restructure and downsizing does occur for all sorts of reasons. But there is a well understood consequence in that standards are set within industries. You will generally find that the level of redundancies reflect industry standards. In most cases, the industry standards exceed the minimum standard of eight weeks.

**Mr GRIFFIN**—What you are also saying is that the actual potential realisable costs of such schemes—

**Mr Heath**—They are built into the decision making.

**Mr GRIFFIN**—are built into the decision making of the organisation?

**Mr Heath**—Yes.

**CHAIRMAN**—I think the issue that people such as the previous witness are raising is that, while they would acknowledge there may be certain degrees of redundancy through restructuring, seeking efficiencies and that sort of thing, that is certainly of a different order from a redundancy that results from the company going into insolvency. Therefore, to have in your, for instance, financial reporting, as you advocate to employees, this sort of contingent provision for redundancy based on the expectation that everyone is going to become redundant because the company might become insolvent is really quite meaningless, because the expectation is that the business will be continuing as an ongoing concern, not going insolvent.

**Mr Heath**—As I say, we do not seek insolvency for companies. We have got a vested interest in maintaining employment. That is where we come from. That is where the employees come from. One would argue that when they need their redundancy the most is when companies collapse suddenly with little or no notice. That is when there is the most emotional turmoil. In other cases, when there is restructuring, there is some time available and there is a process whereby sometimes we can get volunteers and there can be a matching of personal expectations

with the outcome the company seeks, whereas insolvency is brutal and people have not made any provision for—

**Mr McARTHUR**—You are worried about a sudden collapse of a company on a certain day and you want to know what the redundancy position is?

**Mr Heath**—People are thrown into turmoil. In their own minds they believe they have entitlements. If you talk to any employee, they will think they have got entitlements to annual leave, long service leave and redundancy, if they lose their job in such a fashion. That is what their expectations are. When that collapses or you have got a scheme that does not deliver all of their redundancy, suddenly they realise and say, 'Hang on. I can only count on half of what I expected.' It exacerbates the problem.

**Mr McARTHUR**—What has been your experience in terms of the losses? Has it been in redundancy or in the other entitlements of long service leave and maybe holiday pay?

**Mr Heath**—Generally speaking, you are working from a situation where maybe you will get nothing. Obviously, GEERS has brought some certainty to some of those entitlements. Obviously, the law provides some ability for the unions to chase those accrued entitlements. It is sort of denying the reality of the expectations of employees, workers and their families these days.

**CHAIRMAN**—So you do not put any weighting on the long service leave entitlements compared to redundancy payments?

**Mr Heath**—We put equal weighting on them. In the minds of the work force there is equal weighting. They do not draw a distinction. As I say, because this has been so well entrenched now and been used, rightly or wrongly, to a degree of success to restructure—

**Mr McARTHUR**—They just do not get their money, or they get a proportion of it. So, from their point of view, they are all one and the same thing?

**Mr Heath**—Yes, that is right. They say, 'This is the amount of money I thought I was going to get.' That is where their focus turns to being: 'How much money can I get? That is what I will live on until I hopefully find another job.'

**Mr GRIFFIN**—Have you got any research on how long after redundancies occur people tend to be out of work, particularly in your industries? I understand that is a hard thing to do.

**Mr Heath**—That will vary fairly significantly. That is hard to answer. As you know, it depends on the nature of the insolvency. There can be other people who come in and pick up components of the company and there may be some employment fallout from those opportunities. They may be very marketable people who have chosen not to look elsewhere for jobs. An example would be members of AGTS who are highly qualified people with highly sought after skills but were quite happy to start and finish their careers with one employer if they had the opportunity. It is a bit hard to really draw a conclusion, from my experience.

**Mr Gillam**—I would agree with that. Often increased levels of redundancy payment may reflect the difficulty with employees finding new employment in the industry after they have lost their jobs. While you may, in a certain industry, get two weeks a year or three weeks a year for every year of service if you lose your employment, there will be a substantial period before you find another job. In the case of Ansett, which we were talking about before, the only other major player in Australia was Qantas. There are a limited number of jobs for people who work in the airline industry. So if you lose your job it may be six months, a year or two years before another suitable job in Australia comes along.

**Mr GRIFFIN**—If you are attracting a redundancy payment on the basis that you have been with an employer for something like 20 years, chances are you are 45 or 50.

**Mr Gillam**—Which will increase the difficulty.

**Mr GRIFFIN**—You are then in the age group for which on average—you cannot speak only of generalisations—the chances of getting employment quickly are not as high. They are not as high as they are if you are 25.

**Mr Heath**—That is certainly true, yes.

**Mr McARTHUR**—Would you say in the TCF industry there is a predisposition to developing a redundancy package with forecasts of lesser numbers being employed in that industry?

**Mr Gillam**—I could not comment on that.

**Mr Heath**—Certainly it was developed to take account of the realisation that this was an industry that would be subject to ongoing restructuring. Unfortunately, it is still in that situation. Therefore, redundancy arrangements were developed to recognise the reality.

**Mr McARTHUR**—So it then becomes a self-fulfilling prophecy that jobs will be lost, greater redundancies will be paid, and so it goes on.

**Mr Heath**—It is amazing how it is turned around that way on the employees. We would rather there were no redundancies. Let us go back to the days when people had a fair chance of being able to turn up to work and not worry about restructuring. That is not the reality. I am constantly amazed at how companies can continue to restructure and downsize. I often talk to some of my members and veterans of the gas industry and they say that every time we think it might have finished it turns out that it has not. I do not think the employees are necessarily saying, ‘We want this redundancy.’ The fact is that the employer never stops restructuring.

**Mr GRIFFIN**—Surely with the textile industry you are talking about the effects of tariff reductions and the question of cheap imports. If you want to draw that back to employee entitlements, it is on the basis of the fact that Australian workers like to be paid a wage they can live on versus what is happening in some parts of Asia where the major competitors are in the textile industry. The other point in relation to the textile industry in the longer term is the one I made before: if you have worked in the textile industry for 20 or 25 years, you are 45 or 50 and the odds are that you are a migrant woman who probably is not in a situation where there are too many other choices for ongoing employment. That is why we are talking about structuring in

those other areas with redundancy payments which are designed to deal with those sorts of issues.

**Mr Heath**—That is right. You have very specific skills. They have got specialised machines for weaving and so forth. You might be a very highly trained person but those skills are not transportable anywhere outside that industry. You know full well that your opportunities are extremely limited. As you say, there is a significant proportion of migrant women who, almost from the day they landed in Australia, have worked with these companies and have stuck at it through thick and thin. Largely these are very loyal workers.

**Mr GRIFFIN**—They are not going to get jobs as consultants.

**Mr Heath**—No.

**CHAIRMAN**—What is your response to the argument that giving workers' entitlements first priority in terms of creditors—ahead of even secured creditors such as banks—will increase the cost of capital to businesses and therefore make it more difficult for them to operate and, in a sense, increase the likelihood that they will be unable to retain employees?

**Mr Gillam**—I do not think that that sort of shift would markedly increase the cost of capital to business. In reality, the cost of employee entitlements that are lost is not small but in the region of tens of millions of dollars a year compared to the amount of interest paid by corporations and businesses in Australia, which is billions of dollars a year. So, while banks may assume slightly higher risk in lending to businesses if employee entitlements rank in priority, the reality is that the extent of that risk compared to the size of the Commonwealth Bank's loan portfolio is very small. I think that is basically our submission—that it is small in the scheme of things.

**Mr Heath**—The other factor is these enormous human costs. I know with Bradmill the bank was the biggest secured creditor and they had to take into account the views of the work force. They knew, because we ran a very public campaign given that this was going to devastate not only the people who worked there but also the local area. They went out of their way to accommodate the fact that this human cost both within the company and within the local area would reflect on them. Once again, it is a reality. Banks themselves have to take this into account and look for solutions in trying to ensure that wherever possible the human factor is taken into account and those entitlements are delivered if possible. I think it is emerging more and more that people will take into account that you are dealing with human beings and that you would put them first if you could.

**Mr Gillam**—Another highly likely possibility is that, rather than the banks incurring financial losses by failing to have enough security for their loan if they eventually foreclose, you will probably find banks and other financial institutions stepping in a little bit sooner to appoint a voluntary administrator in order to ensure that their financial obligations are met and they receive their money back. That would also have the flow-on effect of ensuring that employee entitlements are met.

**Mr McARTHUR**—That leads us on to the early warning system you are suggesting in your submission. Are you saying that employees should be aware of the credit rating of the business

so that they can have the first go at it and the directors of the company will not use their entitlements to keep the business flowing on to a bankrupt state? Is that what you are saying? Is that a fair assessment?

**Mr Gillam**—Employees should be informed about the ability of the business to meet accrued entitlements and contingent entitlements. That is what an early warning system would provide. It would provide that information not just to employees but also to the unions and also provide it to banks and unsecured creditors. Everyone along the line could then get a better feel for—if the worst case scenario happened and this business fell into insolvency—where they stood. 'I will come after the secured creditors and after the employee entitlements.' It could also have a benefit for unsecured creditors. It could provide them with information about where they are going to sit in the scheme of things.

**Mr McARTHUR**—So you think the early warning system would help to overcome this optimistic director view of the world and that you ought to drop the boom earlier rather than later and therefore all the creditors would be paid out? Is that what you are suggesting?

**Mr Heath**—From my experience, when companies go into administration and the company doctors come in, there are some things that they do straightaway that the work force is aware of—they are glaring and obvious. But companies can get themselves into a state where they cannot find their way out. If we had an earlier warning, then we could agitate; if there were earlier intervention, there might be greater opportunity to restructure companies.

**Mr McARTHUR**—What would the work force do as opposed to the banks in an early intervention scenario?

**Mr Heath**—There is quite often local knowledge around about this, given that they form part of the business. They can see it every day. If they are able to actually have some realistic influence to bring about an examination that might bring in the—as you do in an administration—company doctors, which then—

**Mr McARTHUR**—So they might adopt a cooperative approach in saying, 'Let's keep this business going,' rather than just running it down until such time as they have no further—

**Mr Heath**—Yes.

**Mr Gillam**—The interests of employees certainly lie in continuing a business. Nobody wants to force business out so you no longer have a job.

**Mr McARTHUR**—Have you got some interesting examples of that in your experience where there were some early warning systems to the work force?

**Mr Heath**—I think Bradmill is a classic. The structure of Bradmill was fundamentally flawed and that was obvious for some time. Employees knew it. They had structured a group which brought in companies, components of which never made money—never, ever made money. But the person who was running the company—that is the nature of managerial prerogative—said yes they wanted this particular group and had an idea and brought it together. But then

sometimes it is difficult to undo a vision. Quite clearly, when the administrators got in there, it did not take very long.

**Mr McARTHUR**—And your employees picked that up sooner than management?

**Mr Heath**—They know full well these things. They are involved in the costs of materials and they just knew that these things were not making money at all because they were part of this group. There was no intention for the existing ownership to pull it apart. The consequence was obviously, when this analysis was brought to bear, that these things had to be cut loose. The biggest part of the business, the weaving part, was profitable but it was just simply carrying all the other satellite components along with it and dragging it down. It has a world renowned product for denim and that is what the new owners are now concentrating on to try to retain the existing jobs. As much as we do not want to see jobs lost, obviously you would say that if someone came in and did that earlier and more seamlessly—there were problems with the administration whereby there was uncertain supply with the suppliers, which meant they lost some big customers in the period that they were restructuring—some of these bigger overseas owners that switched to other suppliers would probably still be there and the company would be travelling in much better shape today.

**CHAIRMAN**—Your submission refers to the cost of external administration and highlights some of the hourly fees that are charged by partners and clerks and so on. Do you see an alternative fee structure that might be workable? For instance, would you advocate administrators tendering for work on the basis of a flat fee to undertake the task?

**Mr Gillam**—The AWU certainly recognises that administrators are skilled professionals and they deserve to be remunerated properly. As for a scheme, I think that sort of tendering may be slightly unworkable in the context of voluntary administration where often time is of the essence—you do not have time to seek tenders. In that respect, for example, ASIC makes a submission that administrator fees should be capped by resolution of creditors and information should be given about the type of work they are doing. We would be supportive of that sort of thing so that creditors know what they are getting in for and have an opportunity to review it as, basically, the process progresses. So we would be supportive of that sort of arrangement.

**CHAIRMAN**—There is certainly a perception around that the only people who benefit from an insolvency or voluntary administration or liquidation process are the administrators. The employees, the other creditors and the shareholders all miss out. It is the administrators that soak up whatever actual funds are left in the enterprise. Do you think that that is a fair perception?

**Mr Gillam**—I can understand why that perception exists. They get paid first. They are paid well by community standards. I think it is difficult for some employees who are facing that situation and who were working for a company that had become insolvent to suddenly have administrators in who are earning $450 an hour. It seems absolutely amazing to them. But the reality is that the union recognises that these people could work as accountants. They could work in a lot of other places. If they are not properly remunerated, then they will go to other professions and there will be no administrators left, which is clearly unworkable. So I think there needs to be a middle ground where they are encouraged to stay in the industry and where they make a fair profit for their work but also that creditors are not exploited.

**Mr Heath**—To be fair, if these people, who are highly skilled, do their job properly then employees do see the benefit of their outcome—that is, that they have been able to provide a way to rescue the business and rescue their jobs.

**Mr McARTHUR**—Have you seen some examples of where the administrators, in cooperation with the work force and management, have actually pulled the business out?

**Mr Heath**—I know I keep going back to Bradmill because it is my most recent one, but the receivers did a fabulous job. They worked tirelessly and they faced huge issues. We certainly started out with little hope, but they worked extremely hard and in fact they won the respect of the work force.

**Mr McARTHUR**—So they earned their money in that case and got a reasonably positive outcome.

**Mr Heath**—Yes. They certainly exceeded everyone's expectations and they won the respect of the work force for doing that, even though they also had to implement some hard decisions. At the end of the day, there are 350 more jobs than everyone expected because they were available to work hard on restructure and bide time and then apply it in the meantime.

**CHAIRMAN**—With regard to the federal government's proposal to put employee entitlements on the top of the pile in terms of priority, as I understand it, it is proposed that that provision would only apply to what we might loosely call big business—that is, small business is excluded. What is your view of that demarcation between the two in terms of that proposal?

**Mr Gillam**—Like most things, it depends where you draw that line between big business and small business. To be honest, I am unaware specifically of where that line is proposed to be drawn. I heard a little bit of the previous witness and his opinions on that matter. Certainly, small businesses are less able to meet some requirements and, to a certain extent, they may go easier on small businesses. But certainly we would not want that line drawn or the bar put too high, to put it that way.

**CHAIRMAN**—As there are no further questions, I thank both of you for your contributions to our inquiry. They have been most valuable.

**Mr Gillam**—Thankyou very much and thanks for the opportunity.

**Proceedings suspended from 11.06 a.m. to 11.20 a.m.**

**LOPEZ, Mr George Aubrey, Chairman, Centre of Excellence, Insolvency and Reconstruction, CPA Australia**

**PURCELL, Mr John Anthony, Technical Adviser, Management and Business, CPA Australia**

**MULCARE, Mrs Catherine Mary, Policy Advisor, Corporate Reporting and Governance, CPA Australia**

**CHAIRMAN**—Welcome. The committee prefers that all evidence be given in public, but if at any stage you wish to give part of your evidence or responses to questions in private you may request that and the committee would consider such a request to move in camera. We have before us written submissions from CPA Australia and also a joint submission from the Institute of Chartered Accountants and CPA Australia, which we have numbered 23 and 37. We have also received supplementary submission 23A from you. Are there any alterations or additions that you wish to make specifically to the written submissions at this stage?

**Mr Lopez**—Not at this stage.

**CHAIRMAN**—I invite you to make an opening statement, at the conclusion of which we will move to questions.

**Mr Purcell**—I am a technical adviser with the Management and Business area of CPA Australia. Accompanying me today is Mr George Lopez, also representing CPA Australia. George is a partner with Perth based insolvency practice Melsom Robson and is chair of CPA Australia's Centre of Excellence, Insolvency and Reconstruction. Our submissions have been developed through the activities of CPA Australia's insolvency centre of excellence, a process which enables CPA Australia to capitalise on the intellectual capital of its members within this area of accounting practice. At the outset, I would like to say on behalf of CPA Australia that we appreciate your invitation to discuss our submissions on improving Australia's corporate insolvency laws. We welcome the inquiry as a valuable opportunity to address the function and application of this critical element of Corporations Law.

By way of background, CPA Australia is one of the world's largest accounting bodies, representing 98,000 finance accounting business professionals in Australia, Asia and Europe. Whilst only a small proportion of CPA Australia's members work directly in insolvency practice, its membership is more broadly affected by the operation of corporate insolvency in debtor and creditor situations across the full spectrum of industries—industries of all size and operating type. Two submissions have been presented to the committee. The first submission, No. 23, deals with a number of specific aspects of the operations of insolvency law. The second, a supplementary submission dated 5 August, elaborates on a number of these issues whilst further addressing a range of related topics and policy aspects highlighted in the committee's terms of reference.

CPA Australia's submissions cover a wide range of issues and I would like to briefly highlight five of those issues. Firstly, the current voluntary administration and associated deed of company

arrangement scheme, as it has evolved, whilst widely accepted in the business community and largely satisfying the objectives of its introduction in 1993, presents opportunity for procedural improvement particularly with the overall timing and relationship between first and second meetings of creditors. Evident also is scope for reducing the cost of administration through the use of more innovative and flexible approaches to creditor communications. At a more substantive level, concern is raised as to a lack of protection of the priority indemnity afforded to administrators under circumstances of chargee initiated actions arising during the course of administration.

Secondly, we have concern about the growing practice of suppliers inserting into their supply contracts retention of title clauses. Consideration of a form of registration arrangement is now warranted, though the details of such a scheme are potentially problematic. Additionally, attention needs to be given by the accounting profession to the adequacy of disclosure of inventories subject to ROTs.

Thirdly, I would like to highlight the emergence of the GEERS scheme, which is acknowledged as a substantial government initiative towards addressing the plight of employees displaced as a consequence of employer insolvency. Its application as an administrative prerogative of the Commonwealth's Department of Employment and Workplace Relations, which operates outside of Corporations Law, is however problematic. Moreover, proposals—and employee maximum priority rule amongst them—which potentially elevate employee entitlements above those already comprehensively recognised in the legislation should be viewed cautiously. Rather than this, CPA Australia suggests that the focus should be on achieving better standards of employer compliance with pre-existing obligations.

The fourth issue is that of company liquidations, in particular the aspects of recovery and investigation. I would make four comments about this particular issue. Firstly, CPA Australia believes consideration should be given to the establishment of funding arrangements to assist liquidator investigation of assetless companies. Secondly, the use of phoenix company strategies warrants an appropriate legislative response. Thirdly, over and above a need to address the funding adequacy of ASIC as part of the redressing of assetless liquidations and errant director behaviour, attention could be given to complementary augmentation of liquidator investigative powers. Fourthly, consideration should be given to the removal of the insolvent transaction constraint placed on the operation of section 588FB of the Corporations Act, which deals with uncommercial transactions, thus better paralleling the undervalued transaction provisions of the Bankruptcy Act 1996. Finally, from a broader policy perspective, CPA Australia supports the further cautious investigation of the possible merger of personal bankruptcy and corporate insolvency law.

In conclusion, I thank the committee for inviting CPA Australia representatives to give evidence today. My colleague and I would now welcome responding to any questions on our submissions.

**CHAIRMAN**—The issue of the timing of the first meeting of creditors: some—including CASAC—are advocating extending the period before the first meeting is required to be held, I think, to eight business days. Other evidence we have heard argues that it is very important that the first meeting be held very quickly because of the potential financial position of the company. Can you expand on CPA's view with regard to the timing of that first meeting?

**Mr Lopez**—It might help if I explain some of the practical issues that arise and why administrators in particular seek an extension. We are required to hold the first meeting of creditors within five business days. That provides for some practical issues, one of those being the fact that at present we have to send notices out by mail. Even within the metropolitan area the postal service sometimes takes two days to get mail wherever it needs to get. This problem is exacerbated when the creditors are in the country or interstate—it could take three days. If it is going to take three days for the mail to get to them and they have to make arrangements to attend at the meeting, which is then only one or two days hence, or to appoint a proxy, and they send their proxy form back by mail, sometimes the proxies do not arrive until after the meeting has been held. So there are some practical issues there. The other one, of course, is that you do not always get to know who all the creditors are within the first two days of the administration. If you take that into account together with the fact that it takes a couple of days for the mail to get to its destination, it becomes a real problem. If you have got fax numbers it is not so bad. If we could send notices out by email it would make it a lot quicker, because then you could send it internationally within minutes.

So our view is that an extension to that would be welcome. On the other hand, and I guess we are looking at all viewpoints, if there is a need to replace the administrator—and that is really what the first meeting of creditors generally does—there are only two things that creditors can actually do. The first is to decide to appoint their own administrator if they wish to and the other is to appoint a committee of creditors which will give advice to the administrator. If creditors feel a need to replace the administrator, I can see that it would be better if it were done as soon as possible. But I think you need to err on the other side that all creditors need to be notified and be given due opportunity to either attend at the meeting or to appoint a proxy.

**CHAIRMAN**—In relation to the second meeting, what is your view there of extending the convening period?

**Mr Lopez**—The idea of a voluntary administration is essentially to give directors and creditors an opportunity to decide on the future of the company. If you go back to why voluntary administrations were created in the first place, it was really intended to help companies which had either sound businesses or should be allowed to survive into the future. What that required is that directors came up with some form of a proposal which they put to creditors which provided some means by which the creditors consider the mechanism of proposal by which the company could continue to operate. Under current legislation, the second meeting of creditors has to be held within 28 days of the commencement of the administration, which effectively is three weeks after the first meeting of creditors.

A couple of things arise here. Before the first meeting of creditors the administrator does not even know whether he is going to be the administrator for the remainder of the term of the administration. That is one issue. So he may not be so inclined to do a lot of that preparatory work for the second session. That is a fairly minor reason. But the major issue is that creditors require at least one week's notice of the second meeting, which means the circular and the report by the administrator have to be sent out within three weeks of the commencement of the administration. To prepare a report requires a lot of investigation into the position of the company, any possible recoverable transactions that a liquidator might enter into, for the directors to have prepared a proposal and for the administrator to have considered the proposal and its merits.

Theoretically, it would take two or three days at least and possibly a week for that report to be prepared, which means that within two weeks of the commencement the administrator has to do a lot of things, and in most cases where there is a reasonable possibility of some form of deed of company arrangement being entered into, all the administrator can do at the second meeting is to ask for an adjournment for two months or up to two months. If they are going to do that, it would be better to have the period for the calling of the second meeting extended so that a reasonable report can be prepared and a decision made by them to go to the additional cost of having to adjourn it.

**Mr Purcell**—Whilst there is scope within the legislation for extensions of time to be given, a lot of it requires presentations to courts which similarly are a fairly costly burden on the total administration process.

**CHAIRMAN**—In relation to the second meeting, is it your view that the information that is being provided to creditors, including employees, has to be sent out with the notice of meeting?

**Mr Lopez**—Yes, because the information under what is known colloquially as a section 439A report needs to be sent out a week beforehand at least so that creditors have an opportunity to consider its contents and you have to make a recommendation as well. So, yes, it does.

**CHAIRMAN**—We had a case yesterday—in fact, two—from two witnesses from a failed telecommunications company. The situation was, I think, that the notice of the second meeting was sent out on the Tuesday and they did not get the report and information until the Friday for a meeting on the following Monday. Within that information was a deed of company arrangement proposed that had the effect of excluding them from the GEERS scheme, as it has turned out, and there have been ongoing difficulties ever since over about a 12-month period and they still have not received their entitlements. They raised this issue and the response was that the court had allowed the information to be sent out separately from the notice of meeting and they seem to have had difficulties getting ASIC to look at this and getting the matter resolved.

**Mr Lopez**—I am not familiar with that particular matter so I cannot comment, but my understanding of the law is that the Corporations Act does not say they have to be sent out together but I think it is generally understood that they ought to be sent out together or at least at about the same time. The idea is to give creditors an opportunity to have a look at and contemplate the contents. I have some difficulty with sending out a notice so that it is received a day before the meeting in effect.

**CHAIRMAN**—We have had submissions suggesting that the voluntary administration procedure is being misused in the sense that it is being used as a means of placing a company into liquidation rather than as a means of enabling a company to continue as an ongoing concern. You have suggested in your submission that directors should be able to initiate a creditor’s voluntary winding up in the same way that they can commence the voluntary administration procedure. Would such a proposal take into account the rights of creditors and shareholders adequately?

**Mr Lopez**—One of the reasons why the VA process is used to place companies into liquidation is simply that when VAs came into being the tax laws were changed at the same time so that income tax did not receive a priority. At the same time the tax office developed a process

whereby they would issue a notice which is locally called a section 222 notice which gave directors of companies a number of options in respect of any unpaid liabilities. The options were to pay the debt, to make arrangements to pay the debt, to place the company into liquidation or to place the company into voluntary administration. The problem was that you cannot place a company into liquidation theoretically within 14 days because the notice requirements for a meeting of creditors were 14 days and by the time the directors received the notice a number of days would have passed in either event. So the only reasonable option for directors who could not pay the debts or make arrangements to pay the debt was to put the company into voluntary administration.

I am not sure that that is really an abuse of process. I guess it is a practical solution to a problem that they had. To put a company into liquidation under the normal process does not give the creditors any option either, because all that a company needs to do now to put a company into liquidation is for the directors to authorise the calling of a meeting and for the shareholders to then resolve at the meeting to put the company into liquidation and that is it. So I do not think the creditors are denied any input into the process or that the creditors are losing any rights by the current process. I understand the IPAA may have made a similar suggestion that this be used as a means of placing companies into liquidation rather than the process that is currently being undertaken. I personally do not see that as an abuse of process, but I cannot speak on behalf of the CPA on that one.

**CHAIRMAN**—With regard to deeds of company arrangements—I mentioned this case earlier where there were problems because of the way in which the deed was drawn. The tax office has also expressed concern in its submission that deeds of company arrangement are increasingly being used as a mechanism for companies to avoid paying some creditors, with the capacity to have varying provisions within the deed. Are you aware of these concerns with regard to deeds of company arrangements? What scope is there for preventing those problems?

**Mr Lopez**—Deeds of company arrangement virtually allow any form of proposal to be put up. One of the ways in which a deed can vary the Corporations Act is to provide for differential priority treatment of creditors' claims. I presume that is the issue you are raising here. Any creditor who feels they are being unfairly treated is allowed to apply to the court to have that deed set aside. That facility is available to them. Once again, I do not see that there is much to be gained in removing that flexibility because there may be circumstances in which, for the sake of the survival of the company and for the sake of creditors generally, some creditors may accept that.

I will quote an example I had some years ago. We had a company which was going to go into liquidation and creditors would receive nothing and the employees may have received next to nothing. The employees agreed that they would receive 12c in the dollar, as opposed to having an absolute priority, which allowed the ordinary unsecured creditors to receive 10c in the dollar. That meant that everyone got something out of it. The company survived. The employees kept their jobs and the creditors received future benefits from continued trading with the company. There can be some instances where that could be to the advantage of everyone. Creditors have an opportunity to object to it at a meeting and, if they still feel they have been unfairly treated, apply to the court.

**Mr Purcell**—The deed of company arrangement does require to propose any sort of alteration in priority. Otherwise, by virtue of schedule 8A, those priorities which operate elsewhere in the Corporations Act normally fold into the structure of the deed of company arrangement.

**Mr Lopez**—A prudential deed administrator would be unwise to support a deed which takes away the rights of creditors without first having those creditors understand what the consequences of that change might be and having their support at the meeting.

**Mr Purcell**—It is an important aspect of flexibility in so much as it often deals with intercompany relationships—where there are trading relationships between group entities. It allows those factors to be taken into account in a flexible manner.

**CHAIRMAN**—We have had submissions, particularly from unions, that employee entitlements, including redundancy entitlements, should be included in regular financial reports made available to employees and to unions. Employer organisations have resisted that in their evidence to us on the basis that they say redundancy arrangements are really only a contingent liability. It would be a bit of a moving feast to make an assessment of what they were because of changing employment and so on within a firm. What is the CPA's view of the extent, if any, or whether the provision for entitlements should be reported to employees and unions?

**Mr Lopez**—I really cannot express the CPA's view on that because it is a matter that is outside the area of my centre of excellence. It really is not a matter of corporate reporting, financial reporting. I can express a personal view on that. My view is, once again—and redundancy is only one of the issues—for the sake of clarity, either within the balance sheet or within the notes to the accounts, there should be some declaration as to what the company's contingent liabilities are. There is a real practical difficulty in that, as has been stated before, it is only a contingent liability. It may never occur if the company is successful and continues trading beyond the foreseeable future. I can understand the practical difficulties in accruing redundancy payments. I do accept that there should be some form of disclosure as to what the company's liabilities may be in the event of insolvency. It is a real issue in terms of the going concern concept. I cannot speak on behalf of CPA. It is an issue that CPA has not certainly considered in respect of our submissions.

**Mr Purcell**—If we could take that question on notice. We do have considerable expertise in CPA Australia handling aspects of corporate reporting and we would happily return a written response to you on that particular question. In a similar vein, there are issues in terms of other legislations' test of insolvency. Section 95A of the act takes a very strong cash flow approach to the measurement of insolvency whereas the complexity of accounting, which has a number of issues associated with measurement and timing, may make assessment of a cash position a little more difficult. I would certainly welcome the opportunity to answer that particular question in more detail in writing subsequently.

**CHAIRMAN**—CPA seems, in its submission, to fairly strongly support the concept of setting aside funds in trust accounts of one form or another for accrued and potential entitlements. Again, this is a proposal that is resisted quite strongly by the business representatives who have appeared before the committee. Given that the principal role of CPA members is advising business, what consultation have you had with business on this proposal? How is it that you

seem to persist with the argument for it in the presence of strong resistance to it from business itself?

**Mr Lopez**—When you say strongly proposed, it was one of a number of suggestions. CPA has not said that that is the way it ought to be done or should be done. It is just one of a number of suggestions. Included among those suggestions is the issue of accruing the entitlements. By accruing the entitlements and the recording in the accounting, you are effectively setting the funds aside. You are not saying that you need to have an account that you put the moneys into. Another suggestion is that you enter into some form of insurance scheme or industry trust fund. An industry trust fund effectively is physically putting the funds aside. We are saying that those funds do not belong to anyone other than the employees anyway. If you use an industry trust fund or an insurance scheme, effectively you are physically setting the funds aside rather than simply accruing.

Something has to be done beyond what is the norm and the norm appears to be with the majority of small businesses, at least, to ignore the issue of those liabilities altogether. That, once again, only becomes a problem when the company becomes insolvent. But we are saying, for the purposes of properly recording profits, properly recording what the company’s assets and liabilities are, one of a number of moves ought to be undertaken. The issue of using trust funds or setting funds aside is just one of some of the suggestions.

**Mr McARTHUR**—Would you distinguish between redundancies and other statutory entitlements?

**Mr Lopez**—To an extent I would, simply because redundancy is something that is not an accrued sum whereas annual leave and long service leave are. Long service leave is somewhere between redundancies and annual leave. You know you have to accrue annual leave because you know you will have to pay it. You may not have to pay long service leave if the employees only work for the short term. Redundancies you may never have to pay.

**Mr McARTHUR**—What would be your accounting interpretation of those two accumulating positions? If long service leave is accumulating up to 10, 15 or 20 years, depending on how long the employee has been there, how would you account for that in the company’s books? Whilst you say it may not arise, obviously it is an entitlement in the 10th year of employment.

**Mr Lopez**—I believe that companies should accrue employee long service leave entitlements from day one. Some industries provide for that. The construction industry certainly does by virtue of what is known as the Construction Industry Long Service Leave Fund, into which funds are paid by companies. That is another way it can be handled. Once again, I cannot talk about accounting standards, because that is not my position. My personal view is that companies should accrue entitlements which may arise. With long service leave—

**Mr McARTHUR**—And record it in the books?

**Mr Lopez**—And record it in the books.

**Mr Purcell**—Certainly anything arising out of an industrial award or by virtue of a statutory obligation should be carried as a liability in the balance sheet. Then comes the question as to the cash adequacy to meet those liabilities in the event of insolvency.

**Mr McARTHUR**—What do you say about redundancies in certain industries? Do you think that companies should make provision for redundancies and restructure or do you think that is in the never-never and current management will not have to deal with it?

**Mr Purcell**—I return to the issue that it may be beneficial to show in a balance sheet an emerging liability for redundancy. However, you may have recognised an expense and a liability, but ultimately the issue at stake is whether there is adequate cash to meet those types of liabilities.

**Mr McARTHUR**—Some commentators have suggested that increasing redundancies foreshadowed in the future help short-term industrial disputation and that current management are happy to give away future redundancy payments which cumulatively can be a cause of insolvency of a company.

**Mr Lopez**—Redundancy is a burning issue. It is very difficult to deal with and I think the problem is simply that redundancy is a very contingent matter. As you are probably aware, there is a case on at the moment where the unions are seeking to in fact increase the redundancy payments to employees from a maximum of eight weeks to 20 weeks and to include small businesses which currently are exempt from redundancy payments. It is a very difficult issue to deal with. Once again, from a personal viewpoint, I can understand the reluctance of businesses to simply put funds aside for redundancy which may never, ever occur or to pay into insurance funds. On the other hand, without the recording of that redundancy at least as a contingent liability, creditors looking at a company's records or a company's financial statements may never, ever know what their position is or what their level of exposure is. I am not sure that I have the answers today and I am not sure that we will have the answers for you in the short term.

**Mr McARTHUR**—At least it ought to be canvassed by your organisation. It would seem to me just as a citizen that the redundancies in the case of Ansett were a very big factor in the liquidation process. An earlier witness indicated some quite remarkable redundancy payouts in the case of Ansett. The management were happy to give that away as a short-term advantage, as they saw it, in the industrial negotiation. If there is no financial impediment in the books of accounts, what does the redundancy mean to the company? If your profession cannot put a figure on it, then we might as well negotiate in the never-never.

**Mr Lopez**—That is the issue that we have taken on notice. The CPA is going to have to look at that and come up with a decision or at least a policy on that. As I said, I am not able to speak on behalf of CPA on that. It is an issue. From an insolvency practitioner's viewpoint, I would take the view that companies should show that in the accounts. However, I can understand the practical difficulties in that—

**Mr McARTHUR**—In some format, or they should show that given certain statistics this could be quite a major factor in the company.

**Mr Lopez**—That can be achieved possibly by reference to that in the notes to the accounts rather than in the balance sheet. Understandably, it is not a liability that exists at that point in time. But it is a contingent—

**Mr McARTHUR**—Certainly the bank would be very interested if you have got a redundancy for 25 per cent of your work force.

**Mr Lopez**—I agree.

**CHAIRMAN**—Is there a danger in including those entitlements in the company's accounts that, should a company experience temporary financial difficulties, having those liabilities in the accounts may in fact make it much more difficult for the company to trade out of those temporary difficulties?

**Mr Lopez**—We are going into an area that I cannot comment on on behalf of CPA Australia. But you are right. I do not think you can include a contingent liability or a liability that is that contingent in the balance sheets.

**CHAIRMAN**—Does your colleague want to comment on some of these issues?

**Mrs Mulcare**—In the first instance, I concur on the grounds that we probably should put in a supplementary submission in relation to the way in which these things are accounted for in the financial reports. I guess the principle that I wanted to bring to the table immediately was the fact that financial reports are prepared in accordance with the accounting standards, and that is probably a separate part of the law. There is a fundamental legal requirement under those accounting standards that affects exactly the issues being discussed, and that is that AASB1AA1, in the first instance, requires that financial reports are prepared on a going concern basis and, as such, that limits your ability to report against these things. There are a number of other standards that probably should be referred to, and we would certainly include an analysis of those in a supplementary submission. They include the recognition and measurement of employee entitlements in accordance with AASB1028, as well as provisions in contingent liabilities in accordance with AASB1044.

The ability to say whether or not something should or should not be reported in the financial reports is limited by the legal requirements of these standards. As such, whether or not CPA Australia believes that a particular contingent liability should or should not be recognised for a redundancy is fundamentally affected by the law which limits a preparer's ability to do that. Certainly, there are no limitations on other areas of the financial statements, such as other reports, but there are limitations in accordance with the current accounting standards and the way they are written in the recognition of those liabilities as well as the ability to include its contingent liability. I wanted to bring that to the table in my capacity as corporate reporting policy adviser. We are happy to do that supplementary submission and, as a professional body, certainly are in a position to provide whatever guidance you need on the financial reporting aspects of this issue.

**CHAIRMAN**—Thank you.

**Mr McARTHUR**—In relation to superannuation, I was interested in your suggestion that, although the government has now changed to a quarterly payment of superannuation dues, there should be a monitoring of the superannuation funds' receipt of those moneys. Could you add to that proposition?

**Mr Lopez**—At the moment there is really no monitoring of the superannuation contributions other than by the payment to the super funds. It used to be on an annual basis in the case of small businesses and now it is on a quarterly basis. If payments cease being paid, either in part or in full, to a super fund, the super fund does not have the ability at the moment to take the matter any further to find out why the payments are not being made other than simply to lodge an account with the company. We see that as a bit of a difficulty.

The super funds are being used as a bank, if you like, by companies which are struggling with liquidity problems, just as the tax department has been used as a banker by simply not remitting funds which should be remitted. If there is some means by which the super funds could report to an authority so that the matter can then be followed up—let us say the Australian Taxation Office, because that seems to be the default organisation when companies do not pay by 28 July of each year—the liability then falls into the ambit of superannuation guarantee charge. If there could be some earlier mechanism, it is possible that insolvency could be detected sooner. Hence the liability is lessened, which would result in a greater return to creditors generally.

**Mr McARTHUR**—So it is from an insolvency point of view that you would like the receipt proposition to be looked at, rather than the ongoing difficulty of superannuation actually being paid by companies?

**Mr Lopez**—I do not quite understand that.

**Mr McARTHUR**—There seems to be a difficulty out in the community that some individuals and some companies have been not paying their superannuation but they are not going to go into insolvency. They just do not pay it and then—

**Mr Lopez**—That is right, and that does happen. I think the laws have changed to some extent, though. Since our initial submission the laws may have changed slightly such that employees have the right to find out what has been paid and employers are obliged to inform the employees that the funds have been remitted.

**Mr McARTHUR**—That is right. I am just interested, though, as to why you want to get a receipt of the superannuation fund receiving the money.

**Mr Lopez**—It is really the only reasonable way for individual employees to make approaches. There is an effort on their part as opposed to an obligation by the company to remit those funds, which effectively do not belong to them anyway. We just felt that the superannuation companies, up to that point in time, had no means of ensuring that they were receiving the funds that should have been paid on to them.

**Mr McARTHUR**—If a company made a statement to their board and to their employees that they had made the payment, where could they have made the payment except to the superannuation fund?

**Mr Lopez**—If they have made that statement, that is fine. At the time of our submission the laws had not been changed in that respect.

**Mr McARTHUR**—It is my understanding that, under the new law, they have to make it quarterly now. It has to be paid to the fund of the employee's choice and the employee is entitled to make some investigation of those payments. That seems a reasonable proposition. I am just interested to know why you would want this receipt-type proposition.

**Mr Lopez**—I guess it is fair to say that the changes in the law have gone a long way to achieving what we want to achieve.

**Mr McARTHUR**—So you are happy with that? Are you saying that, from an insolvency point of view, the super being paid on a quarterly basis will be an early signal that one year's superannuation payments will not be allowed to elapse?

**Mr Lopez**—That is right. It is a marked improvement on what used to exist.

**Mr McARTHUR**—In your experience this will be a help, from an insolvency point of view?

**Mr Lopez**—It will certainly help.

**Mr Purcell**—A company going from a situation of solvency to insolvency can happen fairly rapidly. Any legislative improvements which ensure the meeting of those superannuation liabilities, so that they are not affected by the event of a company's insolvency, are very beneficial.

**CHAIRMAN**—It may be too early in the operation of this quarterly payment to make an assessment yet, but can you make some judgment about how long it is likely to take before a company that is not making its quarterly payments is caught up with and the provision is made?

**Mr Lopez**—That, I think, is the real issue. At the moment employees have the right to find out whether moneys have been paid into their super fund, and that is fine. But if the company does not make the quarterly payments it does not report to the employees—not all employees know that they now have this right and if the superannuation fund itself does not take the matter any further, the same situation could continue to arise. A company could still not make superannuation payments and nobody would be the wiser.

**CHAIRMAN**—For a period of time, anyway.

**Mr Lopez**—For a period of time, exactly.

**CHAIRMAN**—The tax office will catch up with this eventually.

**Mr Lopez**—Only after 28 July the following year.

**CHAIRMAN**—So it will still be a 12-month lapse?

**Mr Lopez**—That is a possibility.

**CHAIRMAN**—Or a quarterly lapse?

**Mr McARTHUR**—Are you saying to the committee that, with the quarterly payment, there is no audit process by the authorities that the money has been paid and that the only—

**Mr Lopez**—To my knowledge there is no audit process.

**Mr McARTHUR**—The only real pressure on the employer to pay is the employee's ability to access the account which, because of apathy, they would tend not to do.

**Mr Lopez**—Not necessarily. The employees may not even know that they have that right. They may not be aware of it. It is not necessarily apathy; it may simply be ignorance.

**Mr McARTHUR**—My impression is that it is fairly clear that the employees do have that right if they—

**Mr Lopez**—The employees themselves may not know they have that right.

**Mr McARTHUR**—I think that is in the legislation. That is my understanding. The comment that I picked up personally is that small business are upset with the administrative effort in making the payment quarterly and that there is this audit process. They have to report it, the employee can access the funds and it is just another impost on small business. That is the comment I am picking up. I may be wrong. Would you care to comment on that? It is a bit outside what we are talking about, I know.

**Mr Purcell**—CPAs are currently reviewing aspects of compliance burdens in quite a degree of detail, particularly in the small to medium sized business sector. I will be happy to prepare a separate report for you on our position in regard to that specific burden. A lot of these issues can be tied up in the education of directors as to what their obligations are. Ultimately the responsibility for corporate insolvency does sit with directors. The more directors are aware of particular statutory requirements which affect a company's liquidity, the more they are attuned to making solvency assessments of their companies.

**Mr McARTHUR**—What has been your experience in relation to the payment of these entitlements? Has the lack of payment on superannuation been one of the bigger factors of the lack of entitlement payments in the case of insolvency by smaller companies?

**Mr Lopez**—As an insolvency practitioner, what I have seen is that the lack of ability to make the superannuation payments is an indicator that the company is insolvent. Unfortunately, that information is only known within the company or among the directors who do not make the payments. Other people do not have a warning that the company is insolvent because they are simply not aware that the company is not making those payments, as they may not be aware that the company is not making its payments to the tax office in respect of its BAS returns. I tie superannuation payments together with BAS returns, because both of those seem to follow a similar path.

I talked earlier about companies using the tax office and super funds as bankers. Generally you will find that when a company becomes insolvent there is a series of BAS returns which have not been lodged and payments not made and superannuation payments not made.

**Mr McARTHUR**—Super, tax and some other creditors.

**Mr Lopez**—Creditors are a little different, because if you do not pay your creditor within 30 days they will normally issue you with a reminder and a threat to summons. The tax office does have a follow-up mechanism, but it does not seem to be as assiduously followed as it could be. That is perhaps something to do with their internal systems. The super funds seem to be, I guess, the orphans in that regard in that they just have not had this or, if they have, they have not had this follow-up mechanism to ensure that the payments are made on time. Under the previous legislation, where annual payments were made and it was not until 28 July, it could be a whole year or 18 months worth of payments that might be outstanding, which means that the company may have been insolvent for 18 months before people were even aware of it.

**Mr McARTHUR**—With tax and super, lack of payment becomes clear.

**Mr Lopez**—With tax, lack of payments becomes clear because—

**Mr McARTHUR**—And super?

**Mr Lopez**—Super will be better now because they have to make quarterly payments, but under the previous regime, where they did not have to make payments until 28 July, you could have a company that was operating for 12 months or certainly much more before insolvency became apparent externally. From the internal perspective, if they could not make one month's payments, the directors should have been aware that the company was insolvent. That has always been a problem for us—that these have been allowed to go on for 12 or 18 months, or even two years in some instances, before the company finally went insolvent. In that period of time the situation is simply getting worse and worse, which means that the returns to creditors are getting less and less. That is an area that really needs to be improved.

**CHAIRMAN**—On the super guarantee issue, is there not a requirement under this new quarterly payment provision that the employer has to report to the tax office that they have made the quarterly payment? Therefore, if that report was not received by the tax office, obviously with some timelag, that would be picked up by the tax office?

**Mrs Mulcare**—I think we would probably have to check that with our policy adviser. From personal experience, I was trying to recall who I received the notification from about the new requirements for the superannuation guarantee charge from my own point of view. I recall that that was actually a notification from the ATO of those obligations. If it is not going to be on the BAS statement, I would certainly encourage us to work with a policy adviser in Tax to recommend to the ATO that they include that with a clear statement that it has been remitted, because it is the same date, effectively. So the date that you are making that payment of BAS would be the same date as you would be making your payment to superannuation. So I think that would probably be an easy thing to achieve, with some work with the ATO. We will put that on notice. Once we have done that with the relevant policy adviser we will include that in the submission as well.

**CHAIRMAN**—I turn to the issue of administrators and first to the issue of the independence of administrators. There has been some concern expressed via submissions, including from the tax office, that public confidence in the voluntary administration process is being undermined by a perceived absence of impartiality on the part of administrators. One of the suggestions that has been made is that administrators ought to be appointed on the basis of a random roster system. Do you think that is a practical alternative? Would it overcome the issue of the perception of lack of impartiality or lack of independence on the part of administrators?

**Mr Lopez**—CPA has not formed a view on that. I am prepared to provide a personal view, if you will accept that as my own personal view. I do not have a problem with that. That is the process that is used for the appointment of official liquidators at the moment. I do not see that as being a real problem. The problem may be in the maintenance of the register or roster and who is to maintain that.

At the moment, appointments are made by directors of companies in most instances. There is quite clearly a perception by members of the public and certainly some creditors that because the administrator has been appointed by the directors he must be partial towards the directors. There are some creditors who will, as a matter of course, apply to have alternative administrators appointed at the first meeting of creditors, simply for that reason.

I am not able to comment on that, other than to say that administrators generally—certainly the ones I am involved with—do not have that partial view and acknowledge their independence. I have had complaints to me by directors who have been, I guess, in their minds misled by administrators who said they would do certain things and then after they have been appointed do something else. I guess that is because the directors themselves might perceive that because they have appointed Joe Blow as the administrator he is going to be on their side and do their bidding. That is in most cases—certainly all of the ones I have been involved in and have known about—not the case. There is quite clearly a view by some creditors—I do not believe it is the correct view—that because they have been appointed by the directors they must be on the side of the directors.

**Mrs Mulcare**—Can I offer another practical difficulty from the perspective of independence and the statement of independence, F1, which is our professional standard? One of the other difficulties that arises through rotation is the practical difficulty associated with who would be nominated on a rotation basis and whether or not that person has their own independence issues within the firm they belong to. As that rotation happens, effectively if they happen to always be selected for a particular liquidation or insolvency and they have an independence issue already, they can only then write back and say, ‘We cannot accept this,’ and then it goes back into the pool. It causes some practical difficulties in terms of how you record which ones prior to the rotation. There is also that additional practical difficulty of keeping that record. That is my understanding based on the F1 document.

**Mr Lopez**—That is true as to whether that person takes the next job on or falls to the bottom of the queue. To my mind that is not a real issue because, as I said, the same thing happens with official liquidations. My concern is who actually maintains that roster and who decides who is next on the list, which is the issue. So there will be an administrative cost of somebody to maintain that list and decide who is next on the list to be appointed. The independence issue is one that exists currently with official liquidations, and all administrators have to abide by it.

**Mr Purcell**—Certain perspectives on it would say that within its legislative bounds the act does allow for a degree of competition between insolvency practitioners. I do not practise as an insolvency practitioner—this is partly a personal view—but the competition does encourage quality within the marketplace in the process of administrations.

**CHAIRMAN**—As I understand it, Canada's bankruptcy and insolvency rules have a code of ethics installed within them. Another suggestion has been that that should perhaps become part of our corporations regulations or that the administrator should send a statement of independence to creditors. Would that have any marked effect on the independence issue?

**Mr Lopez**—That would be useful. The IPAA actually has a statement of best practice which looks at the issue of independence. Some of us are not sure that that goes far enough. In fact, in the statement of best practice we are required to indicate what prior relationship we have had with the directors of the firm or the company that has appointed us and to provide a brief description of what the firm does and so on. That is currently in the statement of best practice which, of course, is simply a statement of best practice. It is not compulsory and it is only an IPAA statement. There are many practitioners who are not members of the IPAA.

**CHAIRMAN**—The other issue in relation to administrators is fees. There is a perception that in administrations and liquidations the only beneficiaries at the end of the day are the administrators—that the shareholders and creditors lose out and whatever is left in the company is eaten up in the administration fees. What is the solution to that perception or reality?

**Mr Lopez**—Are you looking for a personal view?

**CHAIRMAN**—Either CPA or personal.

**Mr Lopez**—It is not something that CPA has addressed, so I guess I will simply offer a personal view. The fees are high. The rate of charge is high. Often in my meetings I explain to the creditors that the rate is high. I also have to explain to the creditors that as an official liquidator I am obliged to take on some jobs where there just are no funds and, at the end of the day, we sell the service and the service is based on time and it has to be paid out of somewhere. So, in effect, the system is perhaps unfair in that those companies that have funds are paying for those that do not and it is simply that.

We do address the issue of assetless companies and some means of resolving that issue would then help in administrators and liquidators having another look at their rates. At the moment we simply base it on: of the 2,000 hours that you might spend in a year on administrations, how much of that is chargeable and how much of that is recoverable? It is simply a question of maths and that is how it works out. Administrations which do have funds often pay for those that do not.

**CHAIRMAN**—Would it be practical for the administrator to be required to, in effect, quote a flat fee for doing the job rather than an hourly rate?

**Mr Lopez**—That is practically very difficult, because when you take on a job you often do not know what work is involved, especially with voluntary administrations which proceed on to deeds. You have to remember that when you are first appointed you may know nothing about the

company other than that it is in a certain industry and the directors will give you a list of assets and a list of liabilities. Invariably, the assets get halved and the liabilities are doubled. It is possible for you to estimate, but it is not often possible for you to offer a quote. I wonder what the administrators of Ansett would have quoted as their fee and, if they had, whether they would have got the job or not. It is one of those impossible ones where the fee has been in the millions of dollars. They may not have thought it was going to be that high. You just do not know in some cases. In the smaller administrations you can guess, where they are in and out, or the quick liquidations, you can guess your fee, but it is not often easy.

**CHAIRMAN**—The other problem in relation to fees is the issue of the creditor appointing the receiver and them being able to set the fee and perhaps setting a fee which they regard as appropriate in effect until their position is secured but not taking account of the other creditors and the ongoing administration beyond their own interests being secured.

**Mr Lopez**—That is a major issue. In fact, it is one that CPA has addressed. In terms of receivers and their fees, receivers' fees are not approved by creditors. They are generally approved by their appointor who is generally the secured creditor. It has been argued—and I guess I am not able to provide you with evidence at this stage—that certain banks will say to a receiver, 'This is the rate you will charge us,' and let us say it is at a discount of $100 an hour. They say, 'Until we have received what is due to us and once we've done that, you can then charge the IPAA rate or whatever rate it is that you normally charge.' The problem is that because the receivers' fees are not subject to control by the creditors—the unsecured creditors—it has been argued that in many cases the receivers' fees are far higher than they should be but nobody there is in a position to argue with them because it is the secured creditors that ultimately approve those fees. In many cases, it is in the interests of the secured creditor and the receiver to ensure that there are no funds left for anyone else. Of course, if there are no funds left for anyone else, finding a liquidator who will take on the administration is impossible in many cases or, if they do find someone who will do it for a minor fee, the degree of investigation is not going to be undertaken simply because there are no funds to do it.

**CHAIRMAN**—Do you have an answer to that problem?

**Mr Lopez**—The answer to that possibility is that receivers' fees should be subject to some form of approval either by the courts or by ordinary unskilled creditors. With liquidations, for example, the liquidator has to get approval of his fees from the creditors or from a committee of inspection. If he cannot, he can then apply to the court and the court will then adjudicate on that. So the same process could be undertaken with receiverships.

**CHAIR**—With regard to phoenix companies, do you have a view on what the current impediments are in the law to detecting and dealing with fraudulent phoenix company activity?

**Mr Lopez**—There are no impediments. There is nothing to stop directors continuing along the same lines they have always continued in the past in simply transferring assets from one company to another other than the insolvent trading provisions, uncommercial transaction provisions, of the Corporations Act under section 600—I cannot remember whether it is A or D—of the Corporations Act whereby the ASIC can prevent directors who have been involved in a number of these companies that have gone under from acting as directors in the future. So there is nothing to stop them doing it until they have actually gone through that process a

number of times. It is a real issue and we have addressed that in our submission, recognising that it is an issue.

The question of phoenix companies is not an easy one to deal with really, because if that is the only line of work that the director knows and he sets up a similar company doing the same thing, should he be prevented from earning his living? What we are concerned about is those who use the phoenix company scheme as a means of transferring assets at under value or no value and using the asset or the intellectual capital or intellectual property of the previous company—that is, not paying for it and simply using that to continue again.

**Mr Purcell**—It is very much an abuse of the corporate form. The legislation grants the capacity for people to use a corporate identity through which to trade, and it is one of the significant areas of abuse.

**CHAIRMAN**—To overcome that, would you advocate placing a limit of two or three occasions on which a director can be a director of a company that goes into liquidation and then they are prevented thereafter from being a director? Is there a better solution? Is there any solution?

**Mr Purcell**—To a degree, over time I think it is also, as I indicated before, part of the education process that individuals who take on the mantle of director understand what the liabilities are, though what you are dealing with here is blatant abuse of the corporate form. They are a small number of people and, as George indicated, that may be their only form of their own personal income. To use the corporate form as a process of abuse is something which should be policed. Certainly it may well be worth considering stronger prohibition on individuals who would describe themselves as unlucky as having suffered a series or sequence of insolvencies.

**Mr Lopez**—CPA's view really is not to stop people continuing to operate in the same industry but simply to prevent the abuse of process or the uncommercial transaction process which is currently undertaken, and we are suggesting that some form of legislation to prevent that occurring would be useful—that is, simply by not allowing people to set up new companies unless they have gone through some process to show that the assets that they have transferred from the old company have been independently valued and paid for so that a director cannot simply say, as some directors say at the moment, 'Well, the company owes me $100,000. I'll buy the assets for $100,000 and we'll just set one debt off against the other,' because that, in effect, is giving them a preference ahead of other creditors by doing that. We have not stated an objection to the continuation in the same industry because we do recognise there may be situations where that is all they can do and you should not stop a person earning a living. What we are saying you should stop is a person who continues to earn a living at the expense of creditors whom he has contributed towards not paying.

**CHAIRMAN**—As there are no further questions, on behalf of the committee I thank each of you for your appearance before the committee today and for your contribution to our inquiry. It has been very helpful.

**Committee adjourned at 12.31 p.m.**