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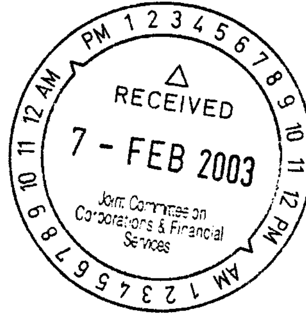


FAXED

7 February 2003

Dr Kathleen Dermody
The Secretary
Joint Parliamentary Committee on Corporations
and Financial Services
Parliament House
CANBERRA ACT 2600
By fax: 02 6277 5719 (17 pages)

Dear Dr Dermody

CPA Australia welcomes the opportunity to provide comments to the Joint Parliamentary Committee on Corporations and Financial Services on the proposed inquiry into the operation and adequacy of Australia's Insolvency Laws.

With approximately 98,000 members, of which 2,500 are either directly involved or have an interest in matters relevant to this issue, CPA Australia is well positioned, and appreciates the opportunity, to provide comments to your Committee. The submission, prepared by our Insolvency and Reconstruction Centre of Excellence has been drawn from the experience and feedback of people in the insolvency field and those from industry and commerce who have encountered and who have had practical experience in dealing with the Corporations Act as it relates to insolvency matters. Accordingly, the focus is directed mainly at the day-to-day issues encountered in the industry with the major theme surrounding the functions of liquidators and administrators.

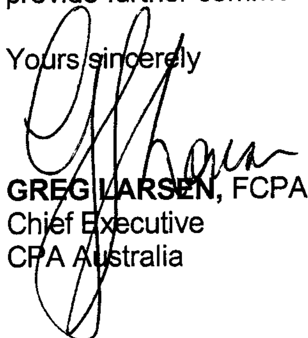
Legal issues are beyond the scope and intention of the paper.

Comment has also been made on employee entitlements being an area in which the practitioner frequently encounters a great deal of emotive fire from employees prior to the introduction of government support for unpaid entitlements. Although the current scheme is still relatively new, there are long delays in receipt of benefits by the employee and some of the operational procedures may be in need of review.

The matter of superannuation entitlements is also a vital issue, both by the nature of its future benefit to the welfare system and the need to conclusively address and solve the problem of un-remitted contributions.

This paper has been prepared over a period when the majority of potential contributors have been on holiday during the recent holiday break. Accordingly, it has not been possible, given the time constraints, to address the multitude of insolvency issues in any great detail. We would be pleased to provide further comment at a later date, should the opportunity present itself.

Yours sincerely



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CENTRE OF EXCELLENCE FOR INSOLVENCY AND RECONSTRUCTION

Submission to Parliamentary Joint Committee on Corporations and Financial Services

Enquiry into Australia's Insolvency Laws

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1. The appointment, removal and functions of administrators and liquidators

1.1 Introduction

Corporations Act Part 5 - Liquidation and Administration

For many decades, corporate insolvency law in Australia provided only three basic avenues for remedy, those being liquidation, Official Management and Scheme of Company Arrangement.

Liquidation was rightfully, and still is, a formal process of winding up a company's financial affairs and the distribution of its remaining assets to creditors and shareholders in accordance with the established principles under the relevant law. Official Management placed a company under the external control of (usually) a liquidator for a term of up to three years on the basis that with sound management, the business had good prospects of recovery and the capacity to pay 100 cents in the dollar to all creditors over that term. The Scheme of Arrangement provided for payment of a sum being less than 100 cents in the dollar in full and final satisfaction of all unsecured debts, but subject to unanimous acceptance by creditors and with the express objective that the company would continue in business.

Due to the complexities involved, both Official Management and the Scheme of Arrangement were slow, cumbersome and expensive processes, whereas liquidation was relatively straightforward and simple and thus remained the most common form of resolution for corporate insolvency.

Following completion of the Harmer Report during the 1980's, a new system of Voluntary Administration and its accompanying Deed of Company Arrangement was subsequently established for corporations seeking a remedy for financial difficulty where, with assistance, there may be some prospect of recovery.

The principal concept of this new system was to administer the company in a way which would either (a) maximize the opportunity for the company or its business to continue in existence or (b) if this were not possible, then to provide a better return to creditors than would be the case in a liquidation. It also provides an alternative path to liquidation.

This system has now been a way of corporate life in Australia for almost ten years and, by and large, has served industry and commerce reasonably well.

As is generally the case with any major shift in corporate law, the initial period of operation is a testing time during which the practical application will reveal any difficulties which may be encountered. It will also test the impact of change on existing legislation and will generate feedback from shareholders, creditors, employees, company officers and representatives and others who may be affected by the new law.

1.2 Voluntary Administration

1.2.1 Sections 436E – First Meeting of Creditors

Section 436E requires the first meeting of creditors to be called within five working days of the appointment of the administrator. This is an extremely short period of time and creates two problems:-

- Often the list of creditors provided to the Administrator is incomplete, a situation that is most often rectified only when the administrator has obtained access to the company's records; and
- While the Act requires that creditors receive two days notice of the meeting, given the vastness of this continent and the difficulties with the postal system , especially in rural regions, not all creditors will have sufficient opportunity to receive sufficient notice of, or to attend, the meeting.

At present, there is little useful information on the company that can be provided at the first meeting of creditors, due to the very short time frame between appointment of the Administrators and the holding of the meeting. In most circumstances the Administrator uses the opportunity to explain the circumstances of his involvement leading up to his appointment and to provide information to creditors on the effects of Voluntary Administration. There is neither the requirement nor the opportunity to present financial or other information such as a creditor listing relative to the company. The broad view is that in its present form, the first meeting lacks substance and could be omitted entirely.

At the first meeting, the only two agenda items that creditors can resolve are:

- The confirmation of or alternate appointment for the Administrator and
- Consideration of the appointment of a Committee of Creditors

These are both important matters that necessitate the convening of a meeting of creditors. However, in very few circumstances is there a challenge to the appointment of the administrator and the creation of committees of creditors is even less frequent.

Perhaps the system could be modified to ensure that notices of appointment are sent to creditors as currently exists, providing certain necessary information, but that the first meeting of creditors not be held unless the Administrator deems it necessary, or creditors to the value of, say, 10% of total debts request that a meeting be held. Such notice should be provided to the administrator within five (5) working days of commencement of the Voluntary Administration and the Administrator will then be required to hold the meeting within a further five working days, in effect, ten working days of his appointment.

Eliminating compulsory first meetings will help reduce the costs, while increasing the operating efficiency of Voluntary Administrations.

As an alternate arrangement to the current format of Section 436E, the meeting could be extended to a later date when more accurate financial information on the company and

particulars of creditors can be provided and the current agenda broadened to give more scope. This would tend, however, to negate part of the aim of the suggestion, which is to reduce the number of meetings and the associated costs.

A further option is to dispense with the S436E meeting altogether and to commence with the S439A meeting say 15 – 20 days after the administration begins. This does, however, provide a disadvantage in that the administrator will, by then have done a lot of work, which may be wasted should creditors wish to appoint another administrator. In that event, the costs of administration will be increased.

1.2.2 Sections 436E – Second Meeting of Creditors

Under current legislation, a second meeting of creditors is to be held 28 days from the appointment of the Administrators, with notice of the meeting being sent out, effectively, 21 days after appointment. At the second meeting of creditors, creditors determine the future of the company in that they may resolve to :-

- accept a proposal for a Deed of Company Arrangement,
- liquidate the company, or
- release the company from Voluntary Administration

Prior to that second meeting of creditors, the directors or other interested parties are required to consider and to submit to the Administrators, a proposal for contemplation by creditors for a Deed of Company Arrangement. In the meantime, the Administrators are required to investigate the company's affairs and to provide a report to creditors providing a brief history, circumstances leading to its insolvency, analysis of its financial position an assessment of the proposal, if one has been submitted. Under current time constraints, this report is to be submitted to creditors with the notice of meeting, that is, within 21 days of the Administrator's appointment.

Not infrequently, especially where a Deed of Company Arrangement involves complex issues, requires access to external funding or involves the sale of property or business, there simply is not sufficient time to put together a proposal, for the administrator to consider and assess the merits of that proposal and to provide a report to creditors within the 21 day period currently required by the Corporations Act.

The creditors do have an option to adjourn the second meeting for up to sixty (60) days and with court approval, further adjournments are possible.

Consideration ought to be given to extending the period by at least another week, to 35, or even 42 days. In our view, this would provide more time to enable meaningful Deeds of Company Arrangement to be proposed, and enable more informative and meaningful reports to be provided to creditors prior to the second meeting.

The result is likely to be further cost savings from the avoidance of having adjourned meetings merely because there has been insufficient time to either prepare meaningful reports or for directors to submit meaningful proposals.

A further issue relates to the view that the 21-day period for convening the second meeting of creditors is too inflexible and that resolutions passed at meetings convened too early may be deemed invalid. In that regard, the use of Voluntary Administrations as an alternative route to liquidation sometimes means that the Administrator is in a position to convene the second meeting of creditors sooner than the Act allows. In that regard, it would be useful if the Act could be amended to provide more flexibility in the timing of the second meeting.

1.3 Administrator's Right of Indemnity – S 443D

Practitioners have raised concerns over the Administrator's right of indemnity in cases where a Receiver is appointed during the term of the Administration. In terms of Section 443E(3), the Administrator's right of indemnity ceases for any future debts or liabilities as from receipt of notification of the appointment of the Receiver.

Given the basis behind the concept of Voluntary Administration, the Administrators MUST be given better protection, especially considering the personal liability attached to Voluntary Administrators in respect of debts incurred in the course of the Voluntary Administration.

As an example, when contracting companies enter into Voluntary Administration, the most significant unencumbered assets are often the value inherent in ongoing contracts and the value of work in progress. That value can only be maintained or enhanced if the company continues with and completes the contract. Failure to complete, or termination by the principal to the contract often results in increased costs of completion and liquidated damages which, at the very least, will reduce any sums outstanding and in the more likely scenario, eliminate any surplus and result in additional claims against the company.

When an administrator continues with a contract and incurs debts in relation to that contract, he becomes personally liable for those debts. However, when a secured creditor appoints a Receiver over the company's property, the consequences are:-

- The administrator has no authority to deal with the company's assets, including the contract. Thus he no longer has control over assets for which he still has personal liability;
- If the receiver decides to terminate the contract, he is, in effect wiping out the value of the asset, yet the administrator is still liable for the debts he has incurred in continuation of that contract;
- In that event, the administrator will have personal liability for debts incurred in good faith, but the assets on which he would normally rely for payment of those debts has, through the actions of others, been extinguished.

This lack of protection is untenable and is not in the spirit of Voluntary Administrations, which seek to protect the company while directors work on a proposal to save the company.

There is no obvious solution to this problem as while the Administrator must act quickly and decisively and generally become committed in the early part of the proceedings, it is also prudent for the secured creditor to be given sufficient time for assessment so as to reach a balanced judgement regarding the appointment of a Receiver.

One solution could be to prevent secured creditors from appointing receivers once administrators have been appointed, without the written approval of the Administrators or leave of the court. This is not unduly onerous and is similar to the restriction currently placed on owners of property being used by the company at the time of the Administrator's appointment.

A less desirable (from the Administrator's viewpoint), but nevertheless feasible, alternative would be to restrict the powers of receivers appointed subsequent to the Voluntary Administration to only those assets which the administrator has not expended funds or incurred liabilities. At least the Administrators will then be in a position to deal with the assets on which he has incurred liabilities, to preserve whatever value is still in them, and to ensure that he realises sufficient from those assets to cover any liabilities incurred in respect of those assets.

1.4 Creditors' Voluntary Winding Up. (Pt 5.5)

There is concern that the current process by which companies are placed into Creditors Voluntary Liquidation leaves the company, its assets and its directors in an unprotected position. This has the potential to reduce the assets available and hence, the potential return, to the general body of creditors.

There is generally a delay of between two and three weeks from the time that directors of a company decide to convene meetings to place a company into liquidation until the appointment of the Liquidator is made and confirmed at the meetings of members and creditors held under Section 497(1). This delay is occasioned by the need to give a minimum of seven days notice of the meetings and the requirement to attach to the notice a summary of affairs of the company and a listing of its creditor details. In practice, these attachments can and generally do, take up to two weeks for completion.

During this period of time, the company is generally insolvent and unable to trade as by so doing, it would incur credit. Quite frequently control is lost and assets such as stock, plant and equipment are commonly uninsured and unprotected and vulnerable to attack by hostile creditors. There are occasions when creditors will, rightly or wrongly, seek to recover stock under spurious claims of retention of title. A company operating from rented premises is also subject to "lockout" by an unpaid landlord.

Many of these problems would be readily resolved if the process of liquidation were to commence in a similar manner as an Administration under Pt 5.3A. If appropriate, the Administrator may quickly terminate the business in an orderly manner without incurring

excessive costs with the matter of liquidation being decided by the creditors at a future meeting under Section 439A. In the interim, assets would remain protected pending sale or return to the rightful owner as appropriate.

The added advantage is that, if directors or other interested parties subsequently believe that the company or its business can be saved either via a Deed of Company Arrangement or by release from Administration, the position is not terminal. Under current legislation, the resolution to wind the company up is generally terminal. Although it is possible to appoint Voluntary Administrators at a later date, that adds to costs of administration.

We acknowledge that by commencing in this manner, the right of members to decide upon the company's future is abrogated. This is a vexed issue, however, as it is questionable as to whether the members should have a right to make this decision at a time when their shareholding effectively has no value. The common law view is that when a company is insolvent, directors owe a duty to the creditors, and not to the shareholders. Further, if the directors have erred in their decision and the company is, in fact solvent, the Voluntary Administration process does provide the facility for the company to be released from Administration.

1.5 Annual General Meetings (Winding Up)

Section 508 requires that Annual General Meetings must be convened where a company is subject to voluntary winding up either by the members or the creditors. There is no requirement for an Annual General Meeting in the case of a winding up by the Court, but prior to finalizing, a report to creditors is generally despatched by the liquidator together with a statement of receipts and payments.

In the case of a members voluntary winding up which continues for more than twelve months there may be some limited purpose in calling a meeting as the members still have a financial interest in the company. The Annual general meeting of members and creditors for a creditors' voluntary liquidation however, rarely attracts a quorum and is generally considered to be an unnecessary drain on funds which may otherwise be distributed to creditors.

The Liquidator's account, which is presented to such a meeting, could be despatched by mail to all members and creditors (or posted on the Liquidator's web site – refer section 3 of this paper) and a meeting held if 5% in number or value of creditors, (in the case of a creditors' voluntary winding up) or members, (in the case of a members voluntary winding up) so desire.

This would also accomplish some savings in administration costs.

Accordingly, we recommend that the AGM requirements of the Corporations Act in relation to companies subject to Voluntary Liquidation be removed to be consistent with companies subject to Official Liquidation.

2. The cost of external administration

2.1 Notices and circulars

A great deal of concern has been expressed at the high cost of insolvency administrations, often with little or no return to creditors. To a great extent, the major expense is reflective of the time cost of professional staff in the profession and external assistance such as legal advice, particularly where the ongoing running and control of a business is involved.

Notwithstanding the valid reasons for cost, many creditors become disenchanted upon receiving advice of a debtor in financial difficulty and tend to the immediate belief that their debt will remain totally irrecoverable. Sadly this is so in many cases and it is little wonder then that meetings of creditors are so poorly attended. Creditors are not prepared to expend their valuable time or that of their staff to attend a meeting in the knowledge that their presence is unlikely to affect the end result of what they already regard as a bad debt to be written off. This is so even when the sum owing is relatively significant.

In the knowledge that this attitude is very prevalent among the general body of creditors, it is disappointing from the practitioner's point of view to see that the cost of time, stationery and postage in preparing and despatching the various notices of meeting (other than the initial advice) to all creditors, is largely wasted.

Against this background, it would be reasonable and cost effective to post all circulars and notices to creditors and members on the Liquidator's / Administrator's web site, or some other public web site, provided that the initial notice is despatched by mail, contains advice and information regarding future notices and extends the option for creditors and members to receive subsequent correspondence by mail or by individual e-mail upon request to the Principal. The web site posting could also be used effectively to provide creditors with a package of information to include particulars of their rights and to provide contact details for those seeking further information.

In addition, the Corporations Act should deem sending notices by e-mail as sufficient. This would not only save costs of postage and stationery, but almost certainly will result in those notices reaching their destination significantly quicker than occurs under the present system of postage, especially where creditors are located in other states or in rural areas.

2.2 Meetings

We see no reason why, in many cases voting by creditors could not be conducted by postal vote, on condition that a formal meeting be held if more than 20% of creditors in number or value give notice at least two business days in advance that they will attend on the day either in person or by personal proxy. This system is currently utilised to determine creditors' wishes under Part IX of the Bankruptcy Act and we believe has application in corporate insolvency as well.

The current form of proxy would require amendment for voting by poll so as to incorporate the various options available under either liquidation or voluntary administration and to include

specific provision to vote for approval of the Liquidator's / Administrator's fees in appropriate cases.

A postal vote gives every creditor the right to have a meaningful vote without the need for personal attendance and hopefully, would provide better balance and a reduction in the incidence of "loaded" voting at stacked meetings.

There will be circumstances where creditors may require discussion at a meeting in order to consider particular resolutions, but the system could cater for that by providing for meetings to be convened if required by the requisite number of creditors.

2.3 Advertising

Advertising requirements for all facets of corporate insolvency are outmoded for current business practices and serve a very limited purpose.

To make effective use of current advertising procedure as a means of credit control, the credit manager of a company would need be thoroughly familiar with every debtor in the company's records and to carefully read the public notices published each day in every local and every national newspaper to be sure of capturing all relative information. In addition, the Gazette would need to be purchased and perused in a like manner.

Acquisition of all these publications each day (including newspapers published on public holidays) would be considerable and the time cost of completing the task of carefully scanning each paper would be out of the question.

Internal credit control is a far more reliable means of monitoring debtor performance rather than relying upon advertisements in newspapers or the Gazette and, provided that any change of address in notified promptly to all business clients, then a notice from the Administrator or Liquidator (as the case may be) should be received at the same time or within a day or two of any notice being published.

In the circumstances it would not be unreasonable to abolish all advertising relative to corporate insolvency in line with current Bankruptcy Law.

It may be appropriate, if advertising were to remain compulsory, to create a "Public Notices" web page wherein all such advertisements may be placed. This has the advantage of cost savings as well as having the advertisements being retained for a longer period, thus increasing the possibility that they be seen by creditors and other stakeholders.

3. The Treatment of Employee Entitlements

3.1 Introduction

Employee claims for unpaid wages and other entitlements have long held a priority for payment above that of unsecured creditors in insolvency administrations. In addition, if the unencumbered property of a company is insufficient to meet the total claims of employees, then that part of the property subject to the floating portion of the charge is available for distribution towards satisfaction of these claims in priority to the claims of the secured creditor.

In more recent times, it has become relatively common for lenders to take a specific charge over book debts and for suppliers to provide goods subject to retention of title clauses. Thus stock and debtors, traditionally being the two predominant sources of assets subject to the floating portion of a charge, are either unavailable or of only minor value to meet employee claims for payment of emoluments.

Following a number of high profile insolvencies over the past two or three years, Government initiatives to satisfy unpaid employee entitlements have been established as a measure of assistance to workers displaced as a consequence of employer insolvency. The current system is known as the General Employee Entitlements and Redundancy Scheme (GEERS).

3.2 Current priorities for employee entitlements – sub contractors

In general terms, Section 556 of the Corporations Act currently provides for a priority of payment of employee claims (subject to certain exclusions) from the unencumbered assets of a company. Those assets subject to a floating charge may also be available for distribution where the unencumbered assets are insufficient to meet the total of all employee claims. The specified order of priority for payment of employee entitlements is:

- Wages and Superannuation payable by the company
- Injury compensation
- Leave of absence
- Retrenchment payments

While the concept of providing a priority as a level of protection to employees from employer insolvency is long standing in Australian business, it may be open to question as to whether the principle is equitable as against sub-contractors and other creditors of similar standing.

Notwithstanding the arguments that, unlike employees, contractors and sub-contractors have opportunities other than the one firm for their income and are, in effect separate business entities, the fact remains that, in many cases, sub-contractors are defacto employees of the company and are dependent for the major part, if not all, their income, from a single source. These people are just as vulnerable as employees and perhaps consideration ought to be given to giving them a priority similar to that awarded to employees.

In some states and in certain industries, subcontractors are granted a form of workmen's lien over projects in which they have performed services. The laws are consistent between states, however and amendment to the Corporations Act will assist to create consistency.

3.3 Application of priority

The question also arises as to whether application of the priority in its current format still has a place in commerce. It is now common to find that those assets subject to a floating charge are largely unavailable for payment of employee claims due to the factoring of debtors or supply of goods under retention of title clauses and the value of available assets is frequently miniscule. Furthermore, it could be argued that since establishment of the GEERS benefit, employee entitlements are afforded an adequate level of protection.

Conversely, prudent management of a company would dictate timely remittance of wage deductions such as superannuation and group tax (although group tax is not the issue here) and for adequate provision to be made for accruing liabilities such as the payment to employees of annual and long service leave. Accordingly, a payment under the GEERS benefit is generally seen to constitute a taxpayer funded measure to compensate for perfunctory management.

Under existing arrangements, payments made by GEERS fall under the ambit of Section 560 and the amount so paid becomes a priority in a winding up with equal priority to that originally held by the person to whom the payment is made. It follows that where there are recoverable assets, any dividends which may have been due to the employees, are paid to GEERS as a partial reimbursement. This benefit is, of course, paid at the expense of other creditors some of whom may hold security and in that sense, the employee priority may be seen to be somewhat iniquitous.

There is argument as to whether the use of GEERS is conceptually sound, whether the taxpayer should be forced to fund the consequences of failures by directors to manage their corporations and whether it was a politically convenient band-aid approach to dealing with employee entitlements.

3.4 The current GEERS benefit

Benefits under GEERS include wages, annual and long service leave including leave loading, payment in lieu of notice and redundancy/retrenchment allowance of up to eight weeks pay. Entitlements are calculated on each employee's wage with an indexed upper limit, which is currently in the order of $80,000 per annum. Bearing in mind that these benefits constitute a form of compensatory welfare payment, it is arguable that the upper limit is grossly excessive and should be fixed at some lower rate. People who retire to an age pension do not receive benefits proportional to their former wage or salary.

It would also be reasonable for items such as annual leave loading, pay in lieu of notice and redundancy allowance to be removed from the benefits payable and payment for long service leave should be restricted to those employees who have actually served for a term of ten years or more.

3.5 Making provision for entitlements

There is currently little incentive or compulsion for a company to make adequate financial provision for employee entitlements. Hence, it is not surprising that on frequent occasions large amounts are outstanding when companies become insolvent. Companies are, in effect using employee entitlements as a form of banker and using employee funds to continue operating. It is paramount, if employee entitlements are to be preserved as far as possible, that steps are taken to ensure that some form of provision is put in place to ensure their availability.

While there may be ways by which enforcement could be achieved, we must be mindful of the cost of compliance and the probability that the majority of companies are well managed and do not require additional constraints and regulations.

On the other hand, inconveniences and compliance costs must be balanced against the social cost of dealing with employees whose entitlements are unsatisfied, in addition to the administrative and contributory expenses incurred in maintaining schemes such as GEERS which are fully funded by the taxpayer.

Corporate insolvency can never be totally eliminated in the world of commerce, but early detection is at least the next best option and can be accomplished to some extent by changes in accounting treatment and by provisioning. Placing funds which do not belong to the company, such as employee deductions for superannuation and group tax beyond the reach of the company, at least until they are required to be expended, would lead to an earlier indication of financial stress. This would not only minimise losses to creditors, but would also improve the chances of the business recovering under a Deed of Company Arrangement.

Opinion has been expressed claiming that withdrawing employee deductions from the working capital of a company is unjust and would restrict its growth. While it may place some restriction on the business, in reality, the funds do not belong to the company and accordingly, should not be employed as part of its working capital.

3.6 Superannuation

The compulsory Superannuation scheme was introduced with the intention of making the Australian workforce less dependant upon the social welfare network in their retirement years.

Although the principle of national superannuation is soundly based in many respects, the scheme as established was somewhat wanting in its procedural application. Initial regulations required that contributions collected were to be remitted only on an annual basis to the fund of the employees' choice and there was (and still is) absolutely no provision for the monitoring of receipt of payment to the fund. Member advices despatched by the funds are still issued annually in most cases and employees have little opportunity to detect defalcation by the employer.

While employers are now bound to remit quarterly, there is still no provision for monitoring the receipt of payment by the fund. It is little wonder then, that a number of more recent insolvencies involving companies with a large number of employees have revealed unpaid employee claims of mammoth proportions.

It is quite clear that regulation will never ensure compliance and it is also evident that in tight financial times, pressing creditor accounts are sometimes given preference over the remittance of employee deductions from money which does not belong to the company.

A logical solution may be found in establishing a system by which the employee deductions are removed from the control of the employer on a regular basis and for the recipient of those funds to maintain a monitoring role over the amounts received and their timing.

This could be achieved by having companies remit superannuation deductions to an industry trust fund (or similar) on a monthly or quarterly basis in line with the frequency of Group Tax deductions, with the fund in turn monitoring receipt and forwarding funds quarterly to the superannuation companies as chosen by the various employees. Implementation of such a programme would not involve significant additional work on the part of the employer and, although there would be some cost for the services of the fund to be met from the deductions, this should be modest in amount.

Consideration may also be given to remitting deductions direct to the superannuation companies as chosen by the employees, provided that the recipient company is prepared to undertake the monitoring role at a cost comparable with an industry trust fund.

A further option lies in combining group tax and superannuation deductions with the total sum to be remitted to the Australian Taxation Office for separation and remittance of the superannuation component to the appropriate funds. This is likely to create a significant increase in the workload of the ATO with a high cost factor, but funding of unremitted superannuation deductions by the taxpayer under a GEERS or similar scheme (if this were implemented) would incur a considerably higher cost.

3.7 Reducing the shortfalls

Some suggestions to reduce the incidence of shortfalls in employee entitlements are:

- Companies to be compelled to make full progressive provision for Annual and long service leave payments and injury compensation payments in a separate designated trust account.
- Provision for PAYG tax deductions to be treated in a similar manner and held in a designated trust account pending remittance.
- Designated employee entitlements to be retained in an industry trust fund or similar and to be properly monitored by that fund.
- ASIC to consider granting fund managers consent to commence recovery processes in appropriate cases upon receipt of advice of suspected shortfalls.
- Any shortfall in trust funds of 10% or more upon appointment of a liquidator, controller, or administrator to constitute prima facie evidence of insolvent trading
- Directors to be held personally liable for any shortfall in the provision for employee entitlements and to be automatically disqualified from holding any current or future appointment as a company officer for a term of say three years from the time of establishing the shortfall but subject to review of disqualification by ASIC in appropriate cases.
- Consider terms of imprisonment for embezzlement or misappropriation of employee funds deducted for group tax or superannuation.
- Accounting standards to be modified to compel disclosure of provisions for employee entitlements (and to provide evidence thereof) in company financial statements.
- Lenders taking security over company assets for new or increased borrowings (including the factoring of debtors) to automatically cede priority over all assets to the extent of employee claims for unpaid wages, holiday pay and long service leave together with all unremitted superannuation and group tax deductions outstanding as at the time of taking the charge.

4. The Reporting and Consequences of Suspected Breaches of the Corporations Act

4.1 Investigations

The process of investigating officers of companies and their conduct is relatively slow, expensive and complex when compared to the avenues available to a Trustee in Bankruptcy under the Bankruptcy Act. In particular, notices issued pursuant to Sections 77C, 81 and 81A of the Bankruptcy Act give the Trustee very wide powers including the investigation of related persons. These sections also have the effect of limiting the use of additional evidence by the Bankrupt in any future action by the Trustee.

Providing investigative powers similar to those in the Bankruptcy Act would give Liquidators more power in matters such as production of records or information and the recovery of preferences if possessed of similar powers through ASIC. It would be preferable, however, if

the involvement of ASIC were limited to the issue of notices in the name of the Liquidator, so that any subsequent action may be pursued by the Liquidator solely without further involvement by ASIC.

4.2 Assetless Companies

One of the primary functions of a liquidator is to investigate the financial affairs of the company and to examine the conduct of its officers and to report to ASIC as appropriate under Section 533.

There are many instances where the report and examination is constrained because the company is bereft of funds. Creditors show little or no interest in financing the pursuit of matters such as the possible recovery of preferences or examination of company officers to determine possible actions under Part 5.7B.

The matter of establishing a fund to meet the cost of examining assetless companies was raised in the Harmer Report but the suggestion was never advanced presumably because of cost. In the current climate where ASIC has limited resources and the incidence of assetless companies is quite high, the absence of a fund for this purpose leaves the system open to abuse by unscrupulous parties. If a director does not wish to be investigated by a Liquidator, in most case he only needs to ensure that the company has only sufficient costs to encourage a Liquidator to take on the job , but insufficient to encourage detailed investigation and recovery action.

Accordingly the time is now appropriate to re-visit the prospect of establishing a fund for this purpose by levying a surcharge on annual returns of companies, if this can be accomplished without adding an undue burden to operating costs.

The Bankruptcy Act provides a facility for Trustees to apply for financial assistance for investigation and recovery action. A similar facility in the Corporations Act would be useful.