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2 March 2007

Mr David Sullivan
The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Suite SG.64
Parliament House
CANBERRA ACT 2600

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

Dear Mr Sullivan

Inquiry into the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007 and related draft regulations

We refer to your invitation to make a written submission to the Parliamentary Joint Committee on Corporations and Financial Services' ("the Committee") inquiry. CPA Australia Ltd and the Institute of Chartered Accountants in Australia ("the accounting bodies") have taken this opportunity to make this joint submission.

Notwithstanding that the Corporations Amendment (Insolvency) Bill 2007 and related draft regulations ("the Bill") do not incorporate all of the recommendations that were outstanding from the Committee's report "Corporate Insolvency Laws: a Stocktake" ("the Report"), the accounting bodies regard this Bill as an important package of much needed reforms that we would wish to see implemented at the earliest opportunity.

While we have identified certain matters that we would wish to see retained on the insolvency law reform agenda, in our view, in relation to those recommendations that were not incorporated into the Bill, there are no matters contained within them that are of such significance that the commencement of the Bill should be delayed.

Considering specifically those recommendations of the Committee's 2004 report that have been identified as not being incorporated in the Bill, the accounting bodies make the following comments.

Recommendation 3

The Committee recommends that an administrator should be prohibited from using a casting vote in a resolution concerning his or her replacement.

The accounting bodies support this recommendation as it gives underpinning to independence as one of the cornerstones of external administration. Additionally, it is noted that the Corporations and Australian Securities and Investments Commission Amendment Regulations 2007 at Item 22 introduces a requirement to publish reasons for exercising a casting vote.

Recommendation 7

The Committee recommends that the Government consider establishing an advisory council comprising representatives of professional organisations including the Insolvency Practitioners Association of Australia, CPA Australia, the Institute of Chartered Accountants in Australia and the Law Council to assist ASIC in relation to the regulation, appointment, registration and removal of registered and official liquidators as well as on issues relating to the maintenance of professional standards of insolvency practitioners.

The accounting bodies have no objection to this recommendation. We note however that, since the release of PJCCFS' 'Stocktake' report in 2004, there have been a number of instances of highly effective liaison between ASIC and the professional bodies in relation to insolvency regulation. For example, ASIC in September 2005 issued Policy Statement 186 *External administration: liquidator registration*. The professional bodies were engaged by ASIC in an extensive consultation process leading up to the release of PS 186. While supportive of any measure which seeks to improve the regulation of insolvency practitioners, the accounting bodies recognise the steps taken in recent years to involve the professional bodies in the development of ASIC's approach to regulation in this area.

Recommendation 8

The Committee recommends that, in its enforcement programs for the lodgement of report as to the affairs of a company (RATAs), ASIC take greater account of the quality of the reports provided.

No comment other than to defer to any comment that the IPAA may make.

Recommendation 10

The Committee recommends that the Government consider amending the law to permit an administrator or a liquidator to recover from directors who fail to ensure that company records are complete and up-to-date, the costs and expense of reconstructing the company's financial records in order to prepare a full and complete report on the affairs of the company. Directors would be held jointly and severally liable.

The accounting bodies agree with this recommendation. The existing law in Corporations Act s 286 establishes the statutory obligation to keep and maintain financial records, breaches of which are a strict liability offence. Significantly s 588E(4) establishes a presumption of insolvency for failure to comply with s 286. Both this potential link to insolvent trading offences and strong judicial statements concerning directors duties to ensure compliance with s 286 (see for example *Daniels v Anderson* (1995) 16 ACSR 607 at 651) provide avenues for penalizing directors in these matters. The further measures described in this recommendation would give added weight to the gravity of breach of s 286 and assist in the conduct of administrations.

Recommendation 12

The committee recommends that reg. 5.3A.02 – administrator to specify voidable transactions in statement – be amended to include rights of recovery against the company's directors for insolvent trading.

The accounting bodies agree with this recommendation. It is noted that the Government supported in principle this recommendation, cross-referencing it to Recommendation 17 concerning the inclusion in administrators' reports "any other matter material to the creditors' decision". This latter recommendation would appear to be adequately addressed in Item 10 of the Corporations Amendment (Insolvency) Bill 2007 which extends the content / scope of s 439A(4)(b). Concerning specific modification of Reg 5.3A.02 to include the specifying of insolvent trading recovery, whilst there may be some difficulty in early quantification, an indication of potential breach of the law in this matter is highly significant to creditor decisions.

Recommendation 13

The Committee recommends that insolvency be removed as a prerequisite for the avoidance of uncommercial transactions which may be challenged by a liquidator. Such transactions are to have taken place during the two year period preceding formal insolvency.

The accounting bodies support this recommendation in principle. Whilst there is clear merit in both strengthening and aligning antecedent transaction provisions with those in bankruptcy law, a cautious approach is required to ensure that the interests of third parties dealing at arm's-length are not adversely affected and that allowance be given to the law's recognition of directors' exercise of business judgement in managerial decision-making.

Recommendation 14

The Committee recommends that the threshold test permitting directors to make the initial appointment of an administrator under the voluntary administration procedure be revised in order to alleviate perceptions that the VA procedure is only available to insolvent companies. The Committee notes the suggestion that the test be reworded to read 'the company is insolvent or may become insolvent'.

The accounting bodies acknowledge merit in the Government's rejection of this recommendation. A departure from the present s 436A(1)(a) wording 'or is likely to become insolvent at some future time' was considered by CAMAC in its Discussion Paper *Rehabilitating large and complex enterprises in financial difficulties*. CAMAC in its subsequent 2004 Report endorsed the present entry into voluntary administration prerequisites¹, providing at page 22 a number of arguments against either a 'may become insolvent' or 'financial difficulty' threshold. We concur with these arguments for retaining the status quo.

Recommendation 18

The Committee further recommends that ASIC publish a guidance note to assist in ensuring that administrators include all matters material to the creditors' decision in their administrator's report.

No comment other than to defer to any comment that the IPAA may make. The accounting bodies note however the series of initiatives contained in Part 2 of Schedule 2 of the Corporations Amendments (Insolvency) Bill 2007 which are directed at achieving better informed creditor decisions.

Recommendation 24

The Committee recommends that ASIC work with the professional bodies to encourage the promotion of best practice standards in remuneration charging and in particular the provision of adequate disclosure of the basis of fees charged by insolvency practitioners and on a more timely basis.

No comment other than to defer to any comment that the IPAA may make.

Recommendation 25

The Committee recommends that an administrator should be prohibited from using a casting vote in a resolution concerning his own remuneration (see also recommendation 3).

Refer our comments in relation to Recommendations 3 and 24.

¹ Recommendation 4.

Recommendation 29

The committee recommends that, as a step towards a better understanding of the nature, effects and extent of insolvent assetless companies, the Government should commission an empirical study of assetless companies.

This recommendation may to a significant degree have been superseded by the establishment and conduct by ASIC of the Assetless Administration Fund.

Recommendation 30

The Committee further recommends that as a first and immediate step, ASIC begin to collate statistics on insolvent assetless companies and publish such figures on a triennial basis together with an analysis.

We agree that there may be some value in the collation and release of such statistics, however this is largely a matter for consideration by ASIC.

Recommendation 31

The Committee recommends that ss 206D and 206F should not be subject to a requirement to have managed two or more failed corporations. They should permit a court, or ASIC at its discretion, to disqualify a person from being a director where essentially two conditions are met: the person is or has been a director of a company which has failed (as defined in s 206D(2)) and the person, as a director of the company (either taken alone or taken together with his/her conduct as a director of any other company) makes him or her unfit to be concerned in the management of a company.

The accounting bodies tentatively concur with the Government's response to this Recommendation. It may be appropriate to allow some lapse in time to assess the effectiveness of the strengthening of ss 206D and 206F, along with the Assetless Administration Fund initiative, before initiating further change to the law. Clearly corporate misconduct and the abuse of the corporate form require prompt and significant regulatory response. Balance is nonetheless required to ensure that individuals are not unduly discouraged from taking on directorships and engaging in legitimate commercial risk.

Recommendation 32

The Committee recommends that the Government in association with the Council of Australian Governments review the adequacy of the arrangements for checking of the business names of companies on State Business Names Registries against the ASCOT database of company names and ACNs.

No comment other than to defer to any comment that the IPAA may make. The accounting bodies understand however that the Small Business Ministerial Council is due some time this year to consider proposals in relation to a business names project conducted under the auspices of the Office of Small Business (Department of Industry, Tourism and Resources). This project addresses, amongst a range of issues, particular complexities arising out of different registration systems and procedures that exist between each of the States.

Recommendation 33

The Committee recommends that the Government consider the proposal to create a statutory process analogous to a Mareva injunction to enable the courts to freeze assets of a director or manager which are prima facie assets on which the corporation has a just claim.

Without necessarily forming a concluded view on this recommendation, the accounting bodies acknowledge the observations made by the Government in its response concerning existing protection against the removal or dissipation of assets. Additionally, the discretionary nature of the granting of a Mareva injunction may not readily lend itself to expression in a statutory form.

Recommendation 34

The Committee recommends that the Government review the processes in place for registering a company with a view to improving the measures for determining the bona fides of those applying to register a company.

No comment other than to defer to any comment that the IPAA may make.

Recommendation 35

The Committee recommends that ASIC consider establishing a hot-line and guidelines for its operation in conjunction with strategically located employees for the purpose of facilitating possible early detection of, and intervention to prevent the implementation of, illicit phoenix activities.

The accounting bodies have no objection to this recommendation. In addition we note that the establishment of the Assetless Administration Fund and continued activities by ASIC's National Insolent Trading Unit (NICU) clearly point to an increased capacity of ASIC to effectively pursue phoenix activities. The information gathering arrangements established as part of these initiatives would indicate that the concerns underlying this recommendation have to some degree been addressed.

Recommendation 37

The Committee recommends that in enforcement programs for the lodgement of external administrators' statutory reports, ASIC also take greater account of the quality of the reports provided.

The accounting bodies have no comment on this recommendation.

Recommendation 40

The Committee recommends that ASIC consider enhancing its capacity to provide more comprehensive, comparable, analyses of statutory reports of liquidators for the assistance of journalists, academic researchers, the public and the Government and its own management requirements. Such information should be assessed in terms of maintaining public confidence in the administration and enforcement of corporate laws.

The accounting bodies have no comment on this recommendation.

Recommendation 41

The Committee recommends that ASIC continuously evaluate the incidence of possible failure to keep books and records adequately as disclosed in external administrators' reports on an annual comparative basis. This measure would allow ASIC to assess the effectiveness of its annual programs for the enforcement of financial reporting requirements.

The accounting bodies clearly recognise the need for the highest possible standards in relation to s 286 requirements and support initiatives directed at achieving this outcome.

Recommendation 43

The Committee recommends that the Minister for Finance request the Corporations and Markets Advisory Committee to review the operation of the Corporations Law Amendment (Employee Entitlements) Act 2000 to determine its effectiveness in deterring companies from avoiding their obligations to employees. Furthermore, in light of the evidence suggesting that some corporations deliberately structure their business to avoid paying their full entitlements to employees and more generally unsecured creditors, the Committee recommends that the review look beyond the effectiveness of the Act and consider, and offer advice on, possible reforms that would deter this type of behaviour.

Given the absence of significant litigation in relation to Pt 5.8A, there is certainly merit in a recommendation which seeks to determine the deterrent impact of the 2000 reforms. The accounting bodies note however that one of the matters to be given consideration by CAMAC in its review of long-tail personal injury liability, was to ascertain whether Pt 5.8A type protections could be more widely applied.

Recommendation 44

The Committee recommends that the Government explore the various measures proposed for safeguarding employee entitlements such as insurance schemes or trust funds giving particular attention to the costs and benefits involved in the schemes.

The accounting bodies have no specific comment here other than to suggest that the continued strengthening of the GEERS and other reforms directed at ensuring the meeting of the priority of employee entitlements are a sufficient response.

Recommendation 47

The Committee recommends that the Government clarify the priority afforded superannuation contributions required to be made after the 'relevant date' of an external administration.

No comment other than to defer to any comment that the IPAA may make.

Recommendation 52

The Committee recommends that the law be amended to clarify that a DCA which incorporates any form of promise of future performance should not be regarded as finalised until all such promises have been fulfilled.

Without necessarily forming a concluded view on this recommendation, the accounting bodies suggest that the type of problem alluded to is best dealt with within both the specific terms of the DOCA itself and the various statutory protections provided within Part 5.3A. Provided that full disclosure is made, creditors are able to agree on format and content appropriate to the circumstances.

Recommendation 54

The Committee recommends that the creditors' voluntary liquidation procedure should be retained and entry into the procedure simplified to enable directors to place a company immediately into liquidation. Where an enterprise is not viable, the law should allow for its swift and efficient liquidation to maximise recoveries for the benefit of creditors.

The accounting bodies note those amendments in Items 89 and 90 of the Corporations Amendment (Insolvency) Bill 2007 which will facilitate a speedier transition from voluntary administration into creditors' voluntary liquidation. Concerning the further related issues of enabling the directors to resolve to appoint a liquidator, the accounting bodies are supportive of such a development, as this would enable the voluntary administration procedure to more clearly function with its intended purpose of facilitating business recovery. Caution would nonetheless be required in any legislative drafting to safeguard, in appropriate circumstance, the interests of members.

Recommendation 55

The Committee recommends that the law be amended so as to permit administrators to apply to a court for an order that a party to a contract may not terminate the contract by virtue of entry by a company into voluntary administration. The court should be satisfied that the contracting party's interests will be adequately protected.

The accounting bodies acknowledge that the treatment of 'ipso facto' clauses is complex introducing the need to balance the efficiency of insolvency administration with the rights of unsecured creditors to protect themselves through contract. The accounting bodies support this recommendation as a significant step to achieve consistency of treatment under moratorium arrangements and to facilitate the orderly assessment of opportunities for business recovery.

Recommendation 58

The Committee recommends that the government support a program of research into the impact of insolvency procedures, if necessary, by providing a specific allocation for the conduct of such research by ASIC, the professional associations and/or commissioned researchers.

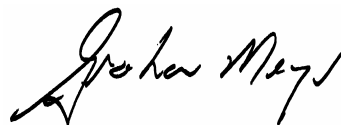
The accounting bodies have no objection to this recommendation.

The accounting bodies thank the Committee for this opportunity to comment on the matters raised in your inquiry.

Yours sincerely



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