To The Financial Services Committee
Financial System Inquiry
Sydney NSW 2001

SECOND ROUND SUBMISSION TO THE FINANCIAL SYSTEM INQUIRY

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Introduction

Thank you for the opportunity to make a submission to the inquiry.

I am a Chartered Accountant and a Fellow of CPA of Australia. I entered the insolvency profession in 1979, obtained registration as a liquidator in 1995 and remained as such until 2013. I continue to take a close and active interest in insolvency practice and insolvency law.

Summary of submission

In my view, proposals in the Insolvency Law Reform Bill 2013 (the Reform Bill) to do with preparation of a Report as to Affairs (RATA) and delivery of records in the external administration should be implemented. The main reform proposal is new section 206BB of the Corporations Act 2001 - automatic disqualification of directors for failure to give report and/or books to external administrator. However, I also support implementation of the uniform insolvency practice rules (Schedule 1).

In 2011 I surveyed official liquidators about their experiences and attitudes in relation to the RATA. One hundred and five (105) official liquidators participated in my written survey. Following the survey and other research I wrote a comprehensive paper entitled "An Appraisal of the Report as to Affairs" for the Insolvency Practitioners Association of Australia, sponsors of my research. (Copy attached.) The following paragraph from my paper gives some idea of how failure to obtain a properly prepared RATA frustrates this part of the financial system:

"Of the many findings coming out of the survey there are two that stand out because they highlight a considerable disparity between what liquidators need and what they receive. The survey shows that liquidators rate receiving a properly prepared RATA – one with full particulars of the company's assets, liabilities and securities – as an important requirement for the efficient performance of their role in a court-ordered winding up. But they also rate the typical RATA that they receive as incomplete, inaccurate and unreliable."

If passed the Reform Bill will amend the Corporations Act to provide a process for the automatic disqualification of directors that have failed to provide a RATA, or the books of the company, to a registered liquidator until they have complied with those obligations. This change would provide an important added incentive for directors to take these statutory duties more seriously which, in turn, should improve efficiency in the conduct of external administrations. However, I believe the reforms should go further by imposing a standard or threshold that must be achieved before a RATA is accepted and the director's obligation discharged. In addition there is an urgent need for an improved RATA form, together with a Regulatory Guide and help services provided by the Australian Security and Investments Commission (ASIC). (Despite the RATA form being one which is unusual, complex and important, ASIC has no guide to what its terms mean and how it should be completed.)

Main submission

The RATA and financial records are essential

The RATA (ASIC Approved Form 507) is a form which is prepared for the purpose of showing the financial position of a company at commencement of its entry into liquidation, controllership or administration. There are eight provisions in the External Administration chapter of the Corporations Act 2001 under which an obligation to prepare such a report is imposed or may arise. (It is required under sections 421A(1), 429(2)(b), 475(1), and 497(5) of the Corporations Act 2001; it may also be used in relation to Sections 438B, 446C, 475(2) and 496(4)). In most circumstances the report is to be prepared by company directors. Since late 2004 sole responsibility for design and content of the form has resided with the Australian Security and Investments Commission (ASIC).

In the survey referred to above, statements that asserted the importance of the RATA received high levels of support by liquidators, as shown in the Table 1:

Table 1

Statement	Agree	Neither agree nor disagree	Disagree
"Failure to submit a RATA results in a liquidator expending additional time and expense in identifying the company's assets and liabilities."	81.9%	14.3%	3.8%
"When lodged with the ASIC the RATA should give creditors and the public visibility as to the position of the company at the date of winding up."	75.2%	17.1%	7.7%
"The lack of a properly prepared RATA from directors is a serious impediment to the efficient and satisfactory fulfilment of the official liquidator's function."	71.4%	18.1%	10.5%
"A RATA is required to ensure a proper preliminary examination of the affairs of the company."	66.7%	22.9%	10.4%
"A RATA is required in order that the liquidator may identify, collect, secure and protect the assets of the company."	60.0%	24.8%	15.2%
"A RATA is the most important information required by a liquidator to commence winding up the company's financial affairs."	44.8%	37.1%	18.1%

Note: The "agree" responses shown here are an amalgamation of the "strongly agree" and "agree" responses. Similarly, the "disagree" responses are amalgamations of "disagree" and "strongly disagree".

Courts, regulatory authorities, government ministers and professional associations have commented on the RATA's importance in the administration of insolvencies, and on the importance of liquidators obtaining company records. For example:

- In 2007 Justice Debelle said: "The purpose and intent of s 475 is to equip the liquidator and the creditors with knowledge of the affairs of the company and thereby to assist the orderly and efficient administration of the winding up. Shortly put, its object is to provide information for the purpose of the winding up: re New Pars Consol Ltd [1898] 1 QB 573 at 576." (Re: Harris Scarfe Ltd (In Liq) (no 2) (2007) SASC 211)

- "Failure by the bankrupt to file his Statement of Affairs has prejudiced his creditor as it has incurred further costs to and delayed the administration of the bankrupt estate: Rees v Stubberfield [1999] FCA 1862."
- In 2010, in recommending a Bill to strengthen penalties where a debtor failed to supply a statement of affairs to his or her trustee, the Federal Attorney-General, Mr McClelland, said:

  > "The statement of affairs is the most important information required by a trustee to commence administering the bankrupt's estate. Failure to comply with the requirement to file a statement of affairs significantly frustrates the trustee's ability to administer the estate in a timely way."
  >
  > The Government showed just how serious it takes these breaches by increasing the penalty fivefold (500%), and simultaneously introducing laws elevating the crime to one which attracts a penalty of imprisonment for 12 months if the debtor does not supply a statement of affairs when demanded by the Official Receiver in Bankruptcy.

- ASIC says that it "regard(s) failure to provide a RATA or to disclose and deliver up books and records as a serious breach of the Act." (ASIC Information Sheet 53 for directors – "Providing assistance to external administrators: books, records and RATA", dated November 2004.)
- In a submission to the Parliamentary Joint Committee on Corporations and Financial Services in 2007, Mr John Melluish, then National President of the Insolvency Practitioners Association of Australia (IPAA), summed up what commonly occurs:

  > "A company goes into official liquidation and the directors may know that they owe that company some money, by way of a directors' loan account, or there have been transactions where that would ultimately cost them money. They go to the liquidator and say, 'No, I do not have any records; they have been tossed in the bin.' The liquidator would then report that to ASIC and the liquidator assistance unit would then take the matter off to a local court. The result of that process would be that they could be fined between $500 and $2,000. So, in terms of an out for them, it is much easier to take the fine of $500 than bother giving the records and exposing themselves to a larger claim."

The abovementioned summary by Mr Melluish accords with my own observations during the 30 years I worked in the insolvency profession. The community in which companies collapse and business people become bankrupt is one in which high levels of scheming, subterfuge and law-breaking are prevalent in the lead up to insolvency. Directors and business bankrupts have plenty of reasons to be apprehensive about the appointment of a liquidator or bankruptcy trustee, because the list of potential actions and lawsuits he or she may take is long. Clearly many of the so-called "minor" insolvency offences committed by them, such as failing to complete a proper RATA/SOA and deliver up books and records, are deliberate attempts to obstruct official proceedings so that their personal wealth may be protected.

<u>The RATA must be of an acceptable standard</u>

As the company law now stands - or to be more precise, as it seems to be interpreted by the ASIC - a director complies with his or her duty to make out and submit a RATA regardless of the quality of the RATA that is produced. If you take the view that a report as to the affairs of a company does not qualify as such unless it attains a certain standard, then it appears that many directors are evading the law. They are being credited with complying with the law when they haven't. In my view a law requiring the submission of a RATA amounts to nothing if it does not impose a standard or threshold that must be achieved before it is accepted.

In the bankruptcy regime the Official Receiver (OR) has advised that he or she may refuse to accept a Statement of Affairs for filing if it is, inter alia, "incomplete". The meaning of "incomplete" is described as:

> "If the debtor has not reasonably attempted to answer all the questions on the statement of affairs …. The Official Receiver will assess whether the unanswered question/s is critical to an understanding of the debtor's affairs and whether the information provided is sufficient, for example: An indication that the debtor owns assets without details of the location or

> estimated value would not constitute a reasonable attempt, and/or An indication by the debtor that they have creditors other than the petitioning creditor without identifying them would not constitute a reasonable attempt."

The OR also says:

> "Should a Trustee receive a completed or partially completed Statement of Affairs form from a bankrupt, that document (or an original copy of it) should be forwarded to the Official Receiver for consideration as to whether or not it has been properly completed. It is not appropriate for Trustees to make a determination as to whether or not such a document is properly completed and therefore acceptable to the Official Receiver."

In my submission a similar set of rules should be introduced in company law, to address the problem, confirmed in my survey, that the typical RATA received by liquidators is incomplete, inaccurate and unreliable.

I also believe that improvements to the design of the RATA form, together with significant official guidance, education and help by ASIC for directors who must complete the form, would improve the standard of the average RATA submitted to external administrators, and, consequently, the efficiency of the provision of this financial service.

Yours faithfully,