

30 January 2020

Insolvency Practices Inquiry

Australian Small Business and Family Enterprise Ombudsman
Via email: inquiries@asbfeo.gov.au

Dear Sir or Madam,

Australian Small Business and Family Enterprise Ombudsman – Insolvency Practices Inquiry Discussion Paper

Chartered Accountants Australia and New Zealand (CA ANZ) welcomes the opportunity to respond to the *Australian Small Business and Family Enterprise Ombudsman – Insolvency Practices Inquiry Discussion Paper* (the Discussion Paper). The majority of registered liquidators in Australia are members of CA ANZ. We have consulted our Insolvency Management Committee and include our responses to the 15 questions outlined in the Discussion Paper in Appendix A. Appendix B provides more information about CA ANZ.

We responded on Thursday 19 December 2019 to the Inquiry in relation a letter dated 4 December 2019 from two insolvency practitioners represented on the Inquiry’s reference group seeking feedback on three main areas for reform. Given this Discussion Paper was released on Friday 20 December, we understand our comments made in that submission will not have been considered in this Discussion Paper. Therefore where relevant, we have reiterated them in this submission.

Key Points

- We encourage the Inquiry to focus on helping small businesses avoid insolvency. Education can play an important role for directors in understanding insolvency process, as well as increasing awareness of the warning signs of insolvency so that they can seek help earlier in the process when there are more options available to them. Consideration should also be given to requiring first time directors to complete an online course, which could be provided by ASIC, and includes some basic education on their roles and responsibilities.
- There are several existing ‘control’ mechanisms in place that deal with costs. However, small business owners don’t understand and appreciate that the financial outcome of an insolvency process is determined by the assets left for creditors. Typically, by the time registered liquidators are engaged, there are limited assets left.
- This Inquiry might give consideration as to whether there should be an appropriate funding model for small business insolvencies with little or no assets and additional funds made available for registered liquidators undertaking such appointments. Alternatively, there may be a role for a government liquidator, similar to the AFSA Official Trustee.
- Whilst registered liquidators may provide pre-insolvency advice, there are some pre-insolvency advisers who are unregulated, unlicensed and typically don’t have professional indemnity (PI) insurance. Good advice should be supported where possible with fact sheets. We consider requiring them to provide

businesses with hard copy fact sheets and the reasons for recommending a particular course of action would help increase transparency and accountability in this sector.

We encourage the Inquiry to strike an appropriate balance between the interests of the small business owner and interests of the creditors of the insolvent small business, who may also be small businesses themselves.

Should you have any questions about the matters discussed above or wish to discuss them further, please contact Karen McWilliams via email at karen.mcwilliams@charteredaccountantsanz.com or phone (612) 8078 5451.

Yours sincerely



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Appendix A

General comments

Page 6 of the Discussion Paper includes a brief overview of ‘the profession.’ For clarity, Registered Liquidators aren’t just in firms with accountants and lawyers, they are accountants and lawyers themselves. This section also includes reference to ASIC’s role in registering liquidators but omits their role in regulating them. Further, there is no reference to the role Chartered Accountants Australia and New Zealand plays in upholding the ethical and professional standards of our members, who represent the majority of Register Liquidators. Our members are required to comply with a professional and ethical framework, which includes APES 110 Code of Ethics for Professional Accountants (including Independence Standards) issued by the Australian Professional and Ethical Standards Board and APES 330 Insolvency Services. We note the Inquiry terms of reference indicated that consultations would be undertaken with “*Industry associations - monitoring and compliance to codes of conduct*”. We would welcome the opportunity to discuss this further with the Inquiry team.

Questions for comment

1. [At the initial consultation with a registered liquidator, should the registered liquidator be required to provide a small business with:](#)

a. [a hard copy plain language fact sheet that outlines the various types of external administration and the role of directors and owners in each?](#)

b. [the reasons for recommending a particular course of action to the directors?](#)

A court listing of all entities commencing winding up is on the public record. We understand ASIC had been sending information to those on the list to advise them to be wary of untrustworthy pre-insolvency advisers also contacting them. We consider this could also be an opportunity circulate a factsheet with the suggested information to the owners of these entities.

Under APES 330 Insolvency Services, our members are unable to provide pre-appointment advice to both the company and its directors in their personal capacity due to the threat to independence. They are able to provide general information on the insolvency process and the consequences of insolvency but this must not be ‘specific to the insolvent entity’s particular facts and circumstances’.

Whilst a registered liquidator could also provide this information on appointment, we don’t consider this to be helpful as by this stage the type of external administration is likely already determined. Additionally, whilst directors could be informed of the reasons for recommending a particular course of action, the recommendations are made to the creditor for their approval. At this stage, the directors no longer have control over the entity.

Further, your question refers to a small business. We note there are a significant range of possible structures utilized by business’ both small and large. You would need to consider AFSA and the Official Trustee when dealing with individuals. That includes individuals, Husband and wife Partnerships, other partnerships, insolvent deceased estates. Indigenous Australians operate small businesses under the CATSI Act. Likewise, Incorporated Associations are under State and Territory Legislation.

Additionally, many people may not speak English to a sufficient standard to understand the relatively complex legal, regulatory and ethical issues involved in considering a particular course of action, nor be able to navigate the pathways to engage with a competent advisor.

2. [Should there be a control mechanism to prevent the total costs of an external administration from consuming the value of the company’s assets? What form could this take?](#)

There are several existing ‘control’ mechanisms in place that deal with costs. Namely, Creditors, Courts, and ASIC and AFSA. We don’t consider the issue to be a lack of control and review mechanisms, but the inability of many to understand and appreciate that the financial outcome of an insolvency process is determined by the assets left for creditors in the insolvency process. Page 9 of the Discussion Paper

states that small business owners have their perception of the value of assets and know the total debts due to creditors – which sets out their expectation for value to be left once all debts are paid. However typically, by the time registered liquidators are engaged, there are limited assets left and if it is an insolvent liquidation, but its very nature, this means that the liabilities exceed the assets of the entity.

We consider it important for small business owners to understand why registered liquidators appear to be costly. They are subject to a significant amount of regulation, they pay fees to ASIC under their industry funding model and are required to carry appropriate levels of professional indemnity insurance. The statutory administrative requirements associated with each appointment have a high minimum level of work and there are associated costs. For example, ASIC registers can be searched for free by journalists but registered liquidators must pay. Small business owners may also not appreciate that market value for assets depends on demand from buyers at the time of the sale, as opposed to their original purchase price for example.

Additionally, as indicated in the Discussion Paper, on some engagements there may be no funds available to pay the fees of the registered liquidator, however they are obligated to complete it. As noted in our earlier submission, some insolvency practices operate a portfolio approach to handle those appointments where they are not paid. This Inquiry might give consideration as to whether there should be an appropriate funding model and additional funds made available for registered liquidators undertaking such appointments. Alternatively, there may be a role for a government liquidator, similar to the AFSA Official Trustee.

3. Should an information sheet of the average costs for a 'day in court' and the average numbers of court days for particular actions be included with each creditors report?

We consider it is important to recognise that litigation is expensive and more than likely to be cost prohibitive in the small businesses context - where the size of the claim might be relatively small, and the target of the claim is likely to be the company's director, where the likelihood of recovery is compounded by the fact that the director's main assets are the business itself and possibly a residential premises.

An information sheet could be a helpful inclusion in the creditors report where the registered liquidator is recommending this course of action. However, we consider it unnecessary to be included in all creditors reports and should be considered on a case by case basis. Further, for this information to be helpful to creditors it could also include information on the expected benefits from the court action. The cost of court action needs to be balanced with the likelihood of recovery of assets and the value of assets that can be recovered.

4. In consideration of technology available today, how beneficial would it be to automatically provide the Annual Administration Return report lodged with ASIC to creditors, directors, owners?

We consider this proposal reasonable. Whilst, this shouldn't add significant additional cost or administration for the registered liquidator to undertake, it might be better handled if ASIC were to make the reports available on their platform instead.

5. Should valuations be provided to, and proposed marketing strategies require approval from, creditors?

We note from the Discussion Paper that this question appears to be specifically in relation to receiverships and lack of transparency for directors. Registered liquidators are appointed by creditors to undertake the process as they have the necessary expertise. We consider the proposal to obtain approval for proposed marketing strategies would slow the sale process and add unnecessary costs without providing any additional value to creditors. This information is sensitive and commercial in confidence, especially when a registered liquidator is tasked as a fiduciary to maximise the return from asset realisations.

6. Should demands to recover payments determined to give a creditor an unfair preference in a winding up require the registered liquidator to include the evidence they relied on in making that determination? A properly founded Unfair Preference Demand should address all the requisite aspects of the claim.

7. Should it be mandatory for individuals seeking to be directors of companies to undertake core education on running a business and the potential risks of personal exposure to liabilities before being eligible for appointment?

The paper provides compelling reasons for the need for education. As our submission dated 19 December notes - education of directors is critical - especially before the company becomes insolvent and increasing awareness of the warning signs of insolvency so that they can seek help earlier in the process when there are more options available to them. Consideration should also be given to requiring first time directors to complete an online course which could be provided by ASIC and includes some basic education on their roles and responsibilities.

8. Should it be mandatory for individuals seeking to start a company or register an ABN to undertake core education on running a business and the potential risks of personal exposure to liabilities?

Yes – we consider this would be an advantage. Please refer to our comments above and in our earlier submission.

9. Where a small business seeks advice when facing financial difficulties, should the individual proposing a course of action be required to provide the small business with:

a. a hard copy plain language fact sheet that outlines the various types of external administration available and the role of directors and owners in each?

b. the reasons for recommending a particular course of action to the directors?

Further to our response to question 1 above and as highlighted in our earlier submission, whilst registered liquidators may provide pre-insolvency advice, there are some pre-insolvency advisers who are unregulated, unlicensed and typically don't have professional indemnity (PI) insurance. They engage with business owners at a time when they are most vulnerable and can often offer unrealistic outcomes. Clear offences are important for reducing pre-insolvency advice and the recent anti-phoenixing legislation provides greater clarity around these. However, to be effective they will need to be monitored and enforced by the regulator.

Good advice should be supported where possible with fact sheets. These are already available from ASIC and ARITA. We consider requiring pre-insolvency advisers to provide businesses with hard copy fact sheets and the reasons for recommending a particular course of action would help increase transparency and accountability in this sector. As noted earlier, education for directors to seek assistance early in the process and to help them identify trustworthy pre-insolvency advice is also important. We consider ASIC's communication to business owners on the court listing to be helpful to ensure they seek support from reputable advisers.

10. How can the safe harbour provision be improved to encourage small businesses to take action early and gain time to assess the viability of the business?

Consideration could be given to a simplified version of external administration, particularly for small businesses.

11. How can accountants and bookkeepers best support small businesses to seek help early?

We are already engaging with our wider membership of Chartered Accountants to help them support their clients. Research undertaken by the Australian Taxation Office (ATO) indicates that small businesses that use accountants regularly have better survival rates. ATO research also indicates that small businesses often need to improve their understanding of cash flow, provisioning and business plans. To this end, we have been working closely with the ATO in the development and promotion of a cash flow coaching kit,

which assists accountants engage small businesses around these issues. A paper version has been available for some time and it is understood that a digital version of the cash flow coaching kit will be released imminently

It is often difficult to convince small business owners that they need to spend money on accounting advice, particularly when they are beginning to experience cash flow problems, as costs such as rent appear more important. Our members undertake a significant amount of pro bono work. A recent survey found that our members already providing on average three hours of pro bono work a week. It is unrealistic to ask accountants, who are often small businesses themselves, to provide more pro bono work.

12. Should increased funding and resources be provided to the financial counselling sector to enable them to provide services to small businesses experiencing financial difficulty?

It is important to distinguish the role of financial counsellors from those of other professionals who also play a vital role in providing services to small businesses experiencing financial difficulty. Financial counsellors can help people deal with debt and ongoing expense issues, make a claim through their insurance company, access grants, offer emotional support and provide information about other available assistance and support. Financial counselling services are different to those provided by professional accountants and financial planners/advisers.

Accountants are trusted everyday advisers to small businesses in Australia. They are well placed to provide holistic advice to small business on their business and personal circumstances and are often small businesses themselves within the local community. We have long advocated for industry reform to ensure that more consumers are able to access good quality, affordable, ethical and professional advice. Our members are also supported in having sensitive conversations with clients suffering financial hardship through our CA Wellbeing initiative, which includes specific guidance – *Guide for Chartered Accountants: engaging with people experiencing mental health issues and financial difficulties*.

We note that the Government has recently announced increased funding to expand financial counselling services in bushfire affected areas, including for the Small Business Bushfire Financial Support Line and locally based providers to deliver face-to-face services. Financial counsellors are well placed as a first point of contact, to case manage/ triage the response and refer people to other appropriate professionals, such as accountants. Accountants are an important part of the solution, particularly in regions where there is a shortage of financial counsellors. Objective, tailored accounting, tax and financial services and advice can be provided by professional accountants to assist immediate and long-term business recovery and continuity.

13. Should the impact on the mental health of small business owners and directors be cause for a pause in proceedings?

Mental Health is a significant issue with all business failures, large and small. However, pausing matters to allow the health of one director to recover may put an unreasonable burden on the business and its creditors, increasing the potential of mental health issues for the other directors and the directors of the creditors.

14. Are there other changes that could assist the parties where there are mental health issues?

As noted in question 12, vouchers for counselling could be helpful.

The Discussion Paper also notes the significant personal cost associated with insolvencies, particularly where the family home is involved. This further highlights the need for upfront education when individuals set up a business and secure their home. If they were presented with the statistics of small business

failures, they would at least go into the process of securing personal assets fully aware of the potential consequences.

15. General submissions are sought on the fairness of having one system and the benefits and risks of implementing different processes so the costs and time to complete an external administration achieves the optimum outcome for creditors, employees and the company.

a) Financial health check

This seems quite a sensible approach and would provide a standard pre-insolvency type process for small business. However, there would need to be appropriate oversight/regulation to ensure independence and quality of service. We would be happy to work with ASBFEO on the development of such as check.

b) pre-packs

As noted in our earlier submission, our members have voiced strong reservations about the pre-pack process. Small business failures often have a negative impact on other small businesses, who are their creditors. The statistics included in the Discussion Paper on UK pre-packs are from the preliminary analysis of pre-packed administrations dated 2007. The 2014 Graham review into pre-pack administration in the UK¹ found that in the majority of pre-packs, no distributions were made to the unsecured creditors of the original business. Further, our members are concerned that pre-packs allow non-viable businesses to be revived and have their problems deferred to a future period. The Graham review found that 25% of all pre-packs in the UK failed within 36 months. It is therefore in everyone's interests to look at preventing small business failures rather than potentially deferring them through a pre-pack arrangement, which could have a negative impact on more small businesses.

If pre-packs are considered, there needs to be an appropriate regulatory framework around their use. It is critical that pre-packs aren't creating illegal phoenix situations, especially when they involve a related party. In the same way as the safe harbour provisions include a requirement for taxes to be paid, we consider any pre-pack process should also have similar requirements. We also recommend pre-pack being a 'one-time' only option for restructuring and that payments for assets be required to be settled within a reasonable time frame. Further, we suggest they should represent an available option for all businesses, not just small businesses.

c) short form process

See above on simplified external administration process.

¹ Page 32 <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>

Appendix B

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand (CA ANZ) represents more than 125,000 financial professionals, supporting them to build value and make a difference to the businesses, organisations and communities in which they work and live.

Around the world, Chartered Accountants are known for their integrity, financial skills, adaptability and the rigour of their professional education and training.

CA ANZ promotes the Chartered Accountant (CA) designation and high ethical standards, delivers world-class services and life-long education to members and advocates for the public good. We protect the reputation of the designation by ensuring members continue to comply with a code of ethics, backed by a robust discipline process. We also monitor Chartered Accountants who offer services directly to the public.

Our flagship CA Program, the pathway to becoming a Chartered Accountant, combines rigorous education with practical experience. Ongoing professional development helps members shape business decisions and remain relevant in a changing world.

We actively engage with governments, regulators and standard-setters on behalf of members and the profession to advocate in the public interest. Our thought leadership promotes prosperity in Australia and New Zealand.

Our support of the profession extends to affiliations with international accounting organisations.

We are a member of the International Federation of Accountants and are connected globally through Chartered Accountants Worldwide and the Global Accounting Alliance. Chartered Accountants Worldwide brings together members of 13 chartered accounting institutes to create a community of more than 1.8 million Chartered Accountants and students in more than 190 countries. CA ANZ is a founding member of the Global Accounting Alliance which is made up of 10 leading accounting bodies that together promote quality services, share information and collaborate on important international issues.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents more than 870,000 current and next generation accounting professionals across 179 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications.