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SUBMISSION: re Proposals Paper: A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia. December 2011.

I refer to your request for submissions in relation to the abovementioned Proposals Paper and thank you for the opportunity to comment. My submission relates to the suggestions regarding the company Report as to Affairs ("RATA") and the bankruptcy Statement of Affairs ("SOA") (paragraphs 227 to 236 and 300 to 302 of the Proposals Paper).

Introduction

I am a Chartered Accountant and registered liquidator who has worked in the insolvency profession for 30 years. I have also had considerable experience in the public service, commerce and private practice in the fields of income tax law, forensic accounting investigation, management accounting and financial accounting.

Recently (Nov. and Dec 2011) I conducted a survey of official liquidators about their experiences and attitudes in relation to the RATA and to associated compliance issues. The survey was part of a research project (almost completed) which specifically concerns the RATA and the SOA. The research is being assisted with sponsorship from the Terry Taylor Scholarship administered by the Insolvency Practitioners Association ("IPA"). One hundred and five (105) official liquidators participated in the written survey. The survey focused on official liquidators - and, hence, section 475 of the Corporations Act 2001 - because the RATA is really put to the test in the environment of Court-ordered liquidation rather than voluntary liquidation. In addition, official liquidators are far more likely to have witnessed first-hand the compliance work in this area that is performed by the ASIC.

Prior to the aforementioned project I completed another related project, which was an extensive analysis of summary prosecution conviction reports issued by the ASIC, with particular focus on the outcome in cases under sections 475 and 530A of the Corporations Act. The resultant research report is being considered for publication by the Australian Institute of Criminology.

General Comments on Paragraphs 227 to 236 of Proposals Paper

<u>Overview</u>

The paragraphs concerning the RATA (227 to 236 and 300 to 302) suggest to me that an attempt is being made to tackle a problem without grasping the magnitude, depth and complexity of the problem.

The Proposals Paper seems to confine its comments and suggestions to one important problem faced by liquidators and the regulator, which is that many directors do not make out and submit a RATA as required by section 475. But this is only one part of the task liquidators and regulators face. The second, and critical, part of the task is to obtain a RATA that is of an acceptable standard. This issue is being addressed in the bankruptcy regime regarding the SOA (see Inspector-General Practice Statement 14 and the judgement of Collier, J, in Wangman v The Official Receiver [2006] FCA 202). However the Proposals Paper does not seem to address this issue for RATAs.

Also, the paper does not address the third part of the task, which is to do with imposing penalties for significant omissions from the RATA.

Main Submission

Further explanation of my argument and ideas follows. I have focused on section 475 of the Corporations Act because this is where non-compliance is most widespread and where corporate and personal insolvency have much in common.

TASK 1	DESCRIPTION OF TASK	DISCUSSION AND SUGGESTIONS

	Get the director to make out and submit a RATA to the liquidator.	Normal practice is to issue a demand (s.475(2)) accompanied by a blank RATA form (ASIC Form 507) and instructions prepared by the liquidator. There are many **reasons why a director served with a demand might fail to comply**:
		• Can't be bothered;
		• Lack of information about company;
		• Disregard for or hostility towards authority;
		• Can't afford the time or cost;
		• Task is too difficult;
		• No books or records;
		• Reasons of dishonesty:
		  o Want to avoid disclosure of assets and/or liabilities;
		  o Want to avoid exposure to the consequences of making false statements.
		• Reasonable excuse, e.g. illness or physical or mental incapacity.
		"Task too difficult"
		Directors often say that they do not understand the RATA form or that it is too complicated. Many liquidators responding to my survey spoke of the obvious difficulty that directors have in understanding the form. Some said the form was even difficult for some accountants (and insolvency practitioners) to understand. This issue clearly needs to be addressed.
		Options for making the task less difficult include the following (all of which should be undertaken by, or be the responsibility of, the ASIC):
		• Make the form easier to understand. Make it more user-friendly.
		In my survey of liquidators there was significant support for the idea of replacing the present RATA – a financial statement – with a questionnaire. This was done in the bankruptcy regime in about 1999. Personally I am not convinced that this is a good idea.
		When liquidators were asked in the survey "What suggestions for improvements or changes to the RATA would you like to make (if any)?", 57 of the 105 liquidators (54%) made suggestions and/or criticised the form. The most common criticism is that the form is difficult for directors to understand, because of its layout (illogical, confusing), its complexity, and the lack of explanations and guidance. A frequent complaint is that directors are expected to

		know unfamiliar rules about the priority of employee and creditor claims and the difference between types of secured creditors. • Provide detailed and cross-referenced written instructions and guide notes. • Provide an Information Sheet. • Provide online (internet) instructions and guide-notes. • Provide telephone support/help. • Consider applications for financial support to obtain assistance. The model for this could be section 475(8) of the Corps Act combined with a GEERS type scheme. In appropriate cases the ASIC would pay the reasonable costs of the director in preparing the RATA; then it would become entitled to reimbursement by the liquidator for that payment as a preferential creditor. I believe that we should also make it clear to directors – through an Information Sheet or Regulatory Guide - that even if they do not understand the RATA form or find that it is too complicated, responsibility for preparing a RATA rests with them and they have a duty to seek assistance. "No books or records" As a general rule this reason/excuse for not complying with a demand for a RATA should be dismissed. In many small to medium sized companies the absence of records will impair but not take away a director's ability to prepare a RATA. Even if there is not a skerrick of paper and no digital records that the director can unearth or access, he or she will usually remember much of what the company owns and is owed, and the names of those to whom it is indebted. The "no books or records" reason/excuse may be a valid excuse for not making a RATA of an acceptable standard (see Task 2), but not for failing to make an attempt and providing at least some information. There is an analogy of sorts in Income Tax law: a company's failure to keep books or records does not mean that it does not have to lodge an income tax return. The ATO takes a firm stand on this issue. The ASIC should adopt the same attitude. Of course, where there are supposedly no books or records, the question to be answered by the directors and investigated is "why". Deliberate destruction? Concealment? Breach of directors duty? Prosecutions should be brought and penalties should be imposed if grounds exists..
TASK 2	DESCRIPTION OF TASK	DISCUSSION AND SUGGESTIONS
	Obtain a RATA that is of an acceptable standard.	As section 475 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 section 475 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. Data from my survey shows that official liquidators rate the typical RATA that they receive as significantly defective. Liquidators were asked to

		consider several statements to do with the inclusion, appropriate valuation and proper classification of assets and liabilities in a RATA prepared by directors without any participation by the liquidator or his or her staff. On the broad question of whether the RATAs received were of a reasonable and acceptable standard, 59% of liquidators said "sometimes", 33 % said "rarely", 7% said "often" and 1% said "never". None chose the highest or second highest ratings of "always" or "often". Liquidators were also asked to rate outcomes within such RATAs in regard to the following seven desirable characteristics: • "All assets that should be in the RATA are included." • "All liabilities that should be in the RATA are included." • "The classification of assets is correct." • "The classification of liabilities is correct." • "Assets are included in the RATA at appropriate values." • "Liabilities are included in the RATA at appropriate values." • "All the information required about assets and liabilities (e.g., location, names and addresses) is provided." For four of these characteristics most liquidators (50% to 60%) rated the level of achievement as "sometimes". In the three other areas most rated achievement as "rarely". The achievement rating of "often" reached 26% in one area and 20% in another, but in others was between 4% and 9%. Other data from my survey shows that 61.9% of liquidators lodge copies of defective RATAs with the ASIC (as required by the ASIC). The main idea behind this procedural requirement is to give creditors, other interested parties and the public visibility as to the position of the company at the date of winding up. (See : Re Harris Scarfe Ltd (In Liq) (no 2) (2007) SASC 211; and New Pars Consol Ltd [1898] 1 QB 573 at 576). Given that large number of defective RATAs are lodged, it would appear that often the RATA information being made available (for a fee) via the ASICs online files is almost worthless. I am aware of one reported case – concerning the banning of a director - in which the ASIC has expressed a view about when a RATA fails to be of an acceptable standard. ASIC spoke then of the absence of "full disclosure". (See Administrative Appeals Tribunal, James Warren Byrnes and Australian Securities & Investments Commission [2000] AATA 333 before Hon Mr R N J Purvis, QC, and Ms J A Shead. Decision 28 April 2000.) But experience tells me that the ASIC is not be prepared to apply that view generally to issues arising under Section 475. <u>Suggestions</u> There are a number of suggestions that I would like to make about procedure and policy in this area. They presuppose that the current RATA (ASIC form 507) is modified to make it a user-friendly form that an ordinary director with the aid of an accountant or lawyer would be able to complete to an acceptable standard. They also presuppose that the assistance measures that I described when discussing Task 1 above – detailed instructions and guide notes, online help, telephone support, etc., - are available. <u>Setting standard for RATA</u> The ASIC should prepare a <u>Regulatory Guide</u> setting out its attitude and expectations concerning the RATA and what it considers to be an acceptable standard.

		Preliminary assessment of RATA As they are now, directors should be required to make out and submit the RATA to the liquidator. The liquidator would then makes an assessment as to whether, prima facie, the RATA is of an acceptable standard. If it is, the liquidator would advise the director/s and lodge copies with the ASIC and the Court. If it is not, the liquidator would send the RATA to the ASIC for its assessment. If the ASIC deems the RATA acceptable, it would inform the liquidator, advise the director/s and file copies in its own office and with the Court. If the ASIC does not "pass" the RATA, it would: • prepare a statement of reasons; • inform the liquidator of its decision and the reasons; • advise the director of its decision and the reasons; • demand a complying RATA from the director/s. (This ASIC decision would be open to appeal at the AAT.) If the ASIC receives a new or amended RATA, it would make an assessment. If the RATA passes this assessment, ASIC inform the liquidator, advise the director/s and file copies in its own office and with the Court. If the RATA fails the assessment, ASIC would inform the liquidator, advise the director/s and begin summary prosecution under Section 475. If the ASIC does not receive a new or amended RATA, it would inform the liquidator, advise the director/s and begin summary prosecution under Section 475. If an acceptable/complying RATA is not received from the director/s after a successful summary prosecution for the offence, a director banning order would be imposed until compliance is achieved.
TASK 3	DESCRIPTION OF TASK	DISCUSSION AND SUGGESTIONS
	Have there been significant omissions from the RATA?	When a RATA is received it is often not possible to tell whether it gives "full disclosure". It may, prima facie, be of an acceptable standard. Omissions may not become apparent until the external administration commences and the incoming administrator/liquidator receives and examines the records and information obtained. If this examination of the company's records and transactions shows that there have been material omissions, the law ought to require that the matter be referred by the liquidator to ASIC as an alleged offence. This might elevate or strengthen the status of the RATA and encourage directors to treat their responsibilities in this area more seriously. At present it appears that the only offence provision that may apply to the situation is section 590(1)(d). However, this provision only applies when a director "fraudulently makes any material omission in any statement or report relating to affairs of the company". And fraud is notoriously difficult to prove. I suggest that an additional law is necessary, to provide that a material omission from a RATA be an offence whenever it occurs (except where there is a reasonable excuse).

This part of my submission make some additional comments on specific proposals in the paper.

Further submission:
Proposals and Comments

227	It is proposed that reforms would be made to consequences connected with lodging a report as to affairs (RATA). Specifically, the penalty for failure to lodge a report as to affairs would be increased to 50 penalty units and aligned across all forms of insolvency. In addition, ASIC would be empowered to issue information gathering notices requiring the former directors or officers to complete the RATA within a stipulated timeframe, which would mirror the current power afforded to ITSA. (Footnote: Section 77CA of the Bankruptcy Act, with an offence provision for non-compliance in section 267B.)
Submission	I support an increased penalty for this offence. Research I carried out (which is now with AIC) shows that the average amount of fine imposed in 2010 for a Section 475 offence prosecuted by the ASIC was $817. (In the four years preceding 2010 the average fine under Section 475 was $1,099 (2006), $1,001 (2007), $818 (2008) and $640 (2009).) This is hardly likely to deter non-compliance when the benefits (no-disclosure of hidden assets, etc) can be great. In my recent survey of liquidators, 56 liquidators reported that they were aware that a conviction had been obtained against a director of a company over which they had been appointed. They were asked to rate the penalty imposed by the court as either "very light", light", "fitting/appropriate", "heavy", or "very heavy". (There was also a "don't know" reply option.) Forty-five of these 56 liquidators (i.e., 80.4% of them) rated the penalty imposed as either "very light" or "light". Also, out of the total 105 liquidators who took part in my survey, 74% agreed or strongly agree with the following statement: "Failure to submit a RATA without reasonable excuse should be treated as a contempt of court".
228	RATAs and statements of affairs are documents that must be completed and provided by directors or debtors at the commencement of an insolvency administration. They are a means of ensuring that practitioners are provided with information necessary to facilitate efficient administration.
Submission	This view – put in more precise terms – was strongly supported by liquidators responding to my survey. A clear majority of the 105 respondents agreed with each of the statements shown below. A substantial percentage said they neither agree nor disagreed (14% to 25%). A small percentage disagreed (4% to 15%). • *"Failure to submit a RATA results in a liquidator expending additional time and expense in identifying the company's assets and liabilities."* Agree 82% • *"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."* Agree 75% • *"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."* Agree 71% • *"A RATA is required to ensure a proper preliminary examination of the affairs of the company."* Agree 67% • *"A RATA is required in order that the liquidator may identify, collect, secure and protect the assets of the company."* Agree 60%
229	Where corporate record keeping obligations have been complied with, it should be a relatively straight forward task for a director to complete a RATA and provide the company's books (or indicate where they may be located, if they are no longer within their control). A refusal to provide a completed RATA or to provide books impacts the ability of a practitioner to properly conduct the administration and may be motivated by a wish to conceal corporate misconduct in

	the lead up to insolvency.
Submission	See my main submission.
230	Where a director does not comply with their obligations to lodge a completed RATA or to provide books and records, corporate insolvency practitioners would continue to refer the breach to ASIC.
Submission	Agreed. But see my main submission.
231	It is proposed that a new streamlined director suspension (not full disqualification) provision would be introduced to support compliance with director obligations to lodge RATAs. The suspension power would also apply to non-compliance with demands by practitioners to directors at the commencement of administrations to deliver the company's books and records. The new suspension process could be utilised by ASIC either as an alternative or in addition to criminal prosecution.
Submission	See my main submission.
232	ASIC would formally demand compliance by the director. If the director did not comply with the demand and they did not provide a reasonable excuse, ASIC would be required to file a notice of suspension on the public record. Upon being recorded on the public register, the director would be prohibited from managing a company.
	232.1. Currently ASIC would assign such a referral to their Liquidator Assistance Program, which would seek provision of the completed form or books; and may commence prosecutions against non-compliant directors. ASIC currently successfully prosecutes approximately 450 directors per annum under this program.
Submission	See my main submission.
233	There would be a delay after lodgement and notice to the director before the suspension became effective, to enable directors to seek a review. Notices would be reviewable internally by ASIC and then by the AAT. The suspension would be delayed during the period of review.
Submission	See my main submission.
234	Suspensions would come to an end upon a person complying with their lodgement obligations; upon a person providing a reasonable excuse for non-compliance; upon the completion of the insolvency administration; or after three years of non-compliance.
Submission	Disagree. If a RATA is not supplied to the liquidator and he or she cannot obtain records or information about assets, he or she is likely to "complete" the liquidation very quickly. The director will then be free to become a director again. For the director it appears to be an attractive "win" "win" situation.
235	Expired suspensions would remain recorded on the public register for five years from the time they take effect. However, in relation to a first suspension, the record of a spent suspension could be removed upon the person having completed a prescribed course in director's duties. Automatic disqualification would occur following three suspensions in relation to unrelated companies.
Submission	
236	The regime would have sufficient flexibility to recognise that there will be occasions where a director may not be able to provide records or may be limited to providing information to the practitioner as to the location of the records. However, this would not extend to situations where a director cannot produce a RATA or records because of their own actions or omissions which were intended to or would have the probable effect, of records becoming not reasonably accessible by the practitioner.
Submission	Disagree. See my main submission. Not having records should hardly ever be accepted as a valid reason for not making out a RATA.
300	Directors are required to provide a RATA of the company in the prescribed form to a liquidator.
Submission	
301	It was announced in January 2010 that the law would be amended to provide for the lodgement

	of this form with ASIC.
Submission	See my main submission.
302	This reform would be progressed in conjunction with additional reforms to the RATA (see paragraphs 227 to 236).
Submission	

Yours faith fully,

Peter J Keenan