24 November 2020

Market Conduct Division
Treasury
Langton Crescent
PARKES ACT 2600
AUSTRALIA

By email: MCDInsolvency@Treasury.gov.au

Dear Sir and Madam,

Insolvency reforms to support small business – subordinate legislation

Chartered Accountants Australia and New Zealand (CA ANZ) appreciates the opportunity to provide feedback on the exposure drafts of the subordinate legislation associated with the Insolvency reforms.

Appendix A outlines our key points and detailed feedback. In developing our feedback, we consulted with our Insolvency Management Committee as well as the Australian Restructuring, Insolvency and Turnaround Association (ARITA) and CPA Australia. We also highlight any relevant matters raised in our previous submissions to Treasury associated with these reforms. Further to this, we note that the majority of registered liquidators (RLs) in Australia are members of CA ANZ.

Key Points

- We acknowledge that issues arise when establishing and implementing rigorous reforms in such a short timeframe. Nevertheless, we believe the long-term integrity of the external administration system, the public's confidence and a sustainable economic recovery are dependent on ensuring robust processes.
- We consider that after the nine months of temporary measures, a very large number of affected companies may have a substantial debt burden, low level of physical assets available for restructure and very modest cash generating prospects. The tragedy of these realities should, in no way, be compounded by allowing a false hope of a Part 5.3B restructure delivering a return to viability.
- We recommend including additional experience and qualification requirements for restructuring practitioners in the rules as we consider it critical that the standards, qualifications and experience of restructuring practitioners are at an appropriately high level whilst backed by a commitment of professional ethics and standards.

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

Simon Grant FCA
Group Executive
Advocacy & Professional Standing

Karen McWilliams FCA
Business Reform Leader
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Appendix A

General comments

As we have previously stated, CA ANZ welcomes these reforms as we have been calling for a Government response to the nation's impending insolvency cliff. These reforms may ultimately offer benefits to viable small businesses.

The new scheme is set for commencement on 1 January 2021, with temporary relief for companies seeking to appoint a restructuring practitioner (RP). We acknowledge that issues arise when establishing and implementing rigorous reforms in such a short timeframe. Nevertheless, we believe the long-term integrity of the external administration system, the public's confidence and a sustainable economic recovery are dependent on ensuring robust processes.

However, given the speed of introduction and the complexity of the reforms this could result in court clarification of the uncertainties, which will inevitably lead to additional costs for those involved.

We strongly recommend the legislation includes a full and comprehensive review late next year (within 12 months) to ensure the reforms are operating as intended, there are no unintended consequences and providing clarification where needed.

Implementation issues

We consider that the anticipated significant surge in corporate insolvencies, expected when the insolvent trading and other temporary measures lapse at the end of 2020, ought to be treated through other institutional measures such as simplified liquidation. This recognises that after the nine months of temporary measures, a very large number of affected companies may have a substantial debt burden, low level of physical assets available for restructure and very modest cash generating prospects. The tragedy of these realities should, in no way, be compounded by allowing a false hope of a Part 5.3B restructure delivering a return to viability. A critical issue here will be for businesses to act early, while their debts have not accumulated to such a level that restructuring is no longer an option.

In this context, we have joined with other accounting and bookkeeping professional bodies, the Australian Small Business and Family Enterprise Ombudsman and the Council of Small Business Australia in calling for a government funded subsidy to ensure small businesses can access urgently needed professional advice on their viability. Under the jointly proposed Small Business Viability Review program, small businesses with up to $10 million in annual turnover would be eligible to obtain a subsidy valued up to $5,000 to access a tailored 15-month plan from an accredited professional on how and whether to turn around their business or exit.

Due to the limited time available for consultation, we have restricted our comments on the draft regulations and rules to those matters we consider to be the most important to address.

Corporations Amendments (Corporate Insolvency Reforms) Regulations 2020

5.3B.03 Eligibility criteria for restructuring

(1) We have no specific objection to the requirement of gross liabilities being less than $1,000,000 as the upper qualifying threshold. We consider it reasonable in the current circumstances and given it includes all liabilities. However, this will be a key element for review shortly after implementation.

(2) and (3) The period of 7 years prescribed for the purposes of paragraph 453C(1)(b) and (c) of the Act seems reasonable.

(5) The definition of liability as a liability or obligation that is not contingent creates uncertainty as to whether this would include accrued employee entitlements. There needs to be clarity as to whether accrued employee entitlements are included or excluded from the calculation of total liabilities.

5.3B.16 Restructuring practitioner must certify restructuring plan

(1) s453E of the Corporations Amendments (Corporate Insolvency Reforms) Bill 2020 refers to the restructuring practitioner for the company making '*a declaration to creditors in accordance with the regulations'*. Regulation 5.3B.16 (1) states that the '*company's restructuring practitioner must prepare a certificate'*. We assume these refer to the same statement and strongly recommend that consistent terminology be used.

(2)(d) We are very concerned that this clause appears to permit the payment of a 'spotter fee' by a RL or RP to a broker for referrals. Chartered Accountants ANZ along with other professional bodies and regulators have expressed strong concern for untrustworthy advisers taking advantage of vulnerable business owners. This regulation appears to endorse the payment of such a fee for the referral of a restructuring engagement. We strongly oppose this endorsement and recommend the regulation is amended to prohibit any such referral fees in order to maintain the high standards of independence expected of RPs and RLs.

(4) We note that there is a strict liability offence if a restructuring practitioner has not made reasonable inquiries or taken reasonable steps to verify the company's business, property, affairs and financial circumstances. However, part (2) of this regulation does not provide any guidance with respect to the extent of inquiries and verification steps that would be considered 'reasonable'. Given this is a strict liability offence, we consider it vital for additional guidance to be included in the regulations as to what would be considered 'reasonable'.

5.3B.20 Creditors may dispute schedule of debts and claims

(5) We note that RPs have just 5 business days to provide a recommendation in relation to a dispute as to the quantum of a creditor's debt. In our opinion, this seems particularly tight particularly given if the creditor disagrees, they can go to court, which will take much longer. We consider it would be preferable to allow more time to enable the RP to request further details and properly consider the claim.

5.3B.33 Functions of restructuring practitioner for restructuring plan

(a) We note the function of a RP includes receiving money from and holding money on trust for the company. It is not clear from the regulations whether this requires funds to be held in a trust account or an account in accordance with IPS 65-1. If the latter, IPS Division 65 will also need to be amended otherwise the RP would be in breach of the funds handling requirements, which are strict liability offences. We recommend that the same regulations apply as for all other external administrations to avoid confusion.

5.3B.44 Declaration by directors—eligibility to be under restructuring and other matters

(1) We strongly recommend that the regulations are tightened such that the declaration by directors is made at the same time as appointing the RP. Directors should not be eligible to appoint a RP without being able to declare that there are reasonable grounds to believe that the eligibility criteria for restructuring are met at the time of making the appointment. Without this criteria, there is a high chance that an small business could commence restructuring, only for creditors to find out a week later that it was ineligible.

(2) A director would need to have sufficient knowledge of S588FE in order to make a declaration which states whether the company has entered into a transaction that would be voidable under section 588FE of the Act. We question whether the directors of small businesses would fully understand the clause and hence the declaration.

5.5.04 Transactions that are not voidable

This section has been drafted such that it is difficult to understand what is meant by it. In particular, the use of double negatives makes it confusing. We recommend this regulation is reworded in clear and easy to interpret terms.

5.5.05 Reports by liquidator

The key difference between the new streamlined liquidation process and the current voluntary liquidation process appears to the reduction of investigation and reporting requirements and reducing meetings. However, the requirements to report to creditors – Initial Report and Statutory Report, remain unchanged and regulation 5.5.05 prescribes the circumstances for the RL to report to ASIC. Therefore, we consider that the costs savings associated with the reduced requirements will be minimal.

Insolvency Practice Rules (Corporations) Amendments (Corporate Insolvency Reforms) Rules 2020

Subsections 20-1(3) and (4) relevant employment

These amendments change the relevant employment criteria from 'and' to 'or' whilst adding Part 5.7B restructures and informal restructuring work. The amendments reduce the standard expected for full RLs whilst introducing experience relevant to RPs. In the same way that the relevant employment experience for the existing receiver class of RL is listed separately, we recommend the same is applied for RPs. Further, we recommend no change is made to the relevant employment test for full RL in order to maintain the necessary high standard of these practitioners.

Subsection 20-2 Qualifications, experience, knowledge and abilities required by applicants for registration to practise only as a restructuring practitioner

We understand the policy intent to support more practitioners being available to undertake small business restructuring engagements. However, we consider it critical to maintain a high level of qualifications, experience, knowledge and abilities for RPs.

In our view, the reforms in their entirety are highly complex and thus may fall short in achieving the desired less costly and more accessible small business restructuring process. Further, these complexities make defining the threshold between the professional attributes of a RL and RP far from clear cut.
We note there is no cost to make an application to register as a RP and therefore it is necessary for the rules to provide sufficient detail as to the expected requirements from applicants to avoid the registration committee becoming overwhelmed with inappropriate applications.

Our following comments focus on possible strengthening of Rule 20-2 (Qualifications, experience, knowledge and abilities required by applicants to register only as a restructuring practitioner) which would serve both the Government's intentions expressed in the Treasury Fact Sheet *Insolvency reforms to support small business* and safeguard the public interest through greater tightening of the scope of recognised accountant (as introduced in 20-2(2)(a) and defined in 20-2(3)).

(2)(a) recognised accountant

We support the requirements for an applicant to be a recognised accountant. As noted in our earlier submissions, the RP requires a sound knowledge of accounting and Australian taxation as they will need to make an assessment on the financial position of the entity, determine its eligibility for the small business restructuring process, co-develop a restructuring plan and assist with execution of that plan.

Further, as a member of a Professional Accounting Association they would be bound by our code of ethics. This is important as creditors will be relying upon the information provided to them and the credibility of RP, who will be certifying the plan, will be critical to the process. Creditors should rightfully expect that the RP giving such a declaration would be of a reputable standing. Directors are also likely to be faced with conflicting demands and ethical dilemmas that the RP may need to oversee and the RP would also need to be independent from the small business.

(2)(b) demonstrated capacity

There has been persistent confusion around the definition of an RP in terms of capacities akin to a RL to the extent that a particularly narrow reading of both proposed section 456B and Rule 20-2(2)(b) could conclude that they are one and the same.

'the *applicant has demonstrated the capacity to perform satisfactorily the functions and duties of a registered liquidator*.'

The first dot point on page 5 of 15 of the Exposure Draft Explanatory Statement makes clear the intention for a 'second tier' of insolvency practitioner whose practice is limited to that of Part 5.3B administrations. We recommend the bracketed words in the dot point be incorporated with Rule 20-2 itself as indicated in the following underlined extract:

'have demonstrated the capacity to perform satisfactorily the functions and duties of a registered liquidator (in the capacity of a registered liquidator who practices solely as a small business restructuring practitioner);'

(3)(a)(ii) ACA designation

Please remove the reference to the designation ACA in this requirement as this is no longer a current designation for members of CA ANZ in Australia.

Professional indemnity insurance

We support the requirement for RPs to hold a Certificate of Public Practice (or equivalent).

Further, Rule 20-2(1)(a) cross-references to clause 20-20(4)(a) of the Insolvency Practice Schedule dealing with qualifications, experience, knowledge and abilities. We recommend that other significant matters addressed in clause 20-20(4)(b) through (i) relating to the taking out of adequate insurance and 'fit and proper' characteristics, should be specifically referenced in the Rules. We consider this preferable to the alternative of leaving this to either inference, or indeed separate requirements promulgated by the professional accounting bodies identified in 20-2(3)(a)-(c).

Qualifications, experience, knowledge and abilities

Rule 20-2 in following on from Rule 20-1 deals specifically with requirements of a RP. Page 5 of 15 of the Exposure Draft Explanatory Statement provides little detail on a number of critical aspects. The reference to section 20-1 in the paragraph which reads "These requirements - - - suitability." in terms of what is required of a liquidator generally, begs the question of the extent to which specific matters dealt with in Rule 20-1 around qualifications and experience are either specifically, or with some variance, intended to be applied to a RP applicant.

Applying these various matters dealt with across 20-1(2) in strict terms to a 20-2 RP applicant would seem self-defeating, whereas allowing, these to be matters the registration committee may consider at their discretion lacks the certainty that should be present in such an important area of regulatory oversight. For the avoidance of doubt, we recommend the addition of an appropriately drafted relevant employment clause similar to that in 20-1(2)(c) or (d) with appropriately defined hours for the RP applicant.

Further, the legislation and processes are complex. Practitioners undertaking these appointments require adequate knowledge in insolvency law, particularly given Part 5.7B appointments mirror many aspects of Part 5.7A appointments. In order to be able to certify the restructuring proposal and advise directors regarding voidable transactions (for the purposes of the director's declaration), the RP will need to have a sound understanding of these types of transactions.

Therefore, we recommend criteria similar to that identified in 20-1(2)(b) dealing with academic requirements will need to be included in relation to RP applicants in 20-2, particularly given both the seminal development of Part 5.3B restructuring and the practitioner being limiting to undertaking these engagements.

Additionally, there is the practical matter of the speed at which such training of sufficient depth and rigor can be 'brought to market'. The development of a single Australian Qualification Framework Level 8 unit, that we believe would suitably upskill a practitioner in the application of Part 5.3B restructuring, along with wider external administration and corporate law contexts, would potentially take a number of months to develop.

If, as seems likely, those professional bodies identified as the source of recognised accountant(s) will have a significant role to play in such capacity building, it should be appreciated by both Treasury and Government that the availability of a suitably equipped cohort of practitioners cannot be expected until well into the new regime's operation. The cost of developing such training is not inconsequential, and whilst there may be scope for synergies through collaboration, we suggest Government provide funding as part of ensuring the broader success of these insolvency law reforms.

Subsection 60-1C Remuneration determinations

We note that this rule permits the determination of the remuneration only on or before the appointment of the RP. It will be extremely difficult for the RP to provide a fixed fee determination at the commencement of the engagement. The RP will have to address a number of variables including the various requirements to settle and resolve creditor claims. In our members' experience, most small business company's books are not up to date at the time of appointment and typically most creditors will prove a different figure to that reported by the company.

115-1 Application of amendments relating to liquidator registration conditions

We support the amendment to the new triennial continuing professional education (CPE) requirement. We have advocated for this change for some time to increase diversity in the profession. However, we note that section 115-1 appears to restrict the application of this new CPE requirement only to practitioners registered after the commencement of Schedule 1 – Corporate Insolvency reforms. We recommend this be expanded to also encompass all renewals after the commencement date.

Other comments

Industry Funding Model (IFM)

The explanatory statement for the regulations notes that the exposure draft does not include:

- proposed amendments to the to *the Corporations (Fees) Regulations 2001* to temporarily waive fees, until 30 June 2022, associated with registration as a registered liquidator to encourage more practitioners to enter the market, nor:

- amendments to *the ASIC Supervisory Cost Recovery Levy Regulations 2017* that are needed to factor the new restructuring process into a leviable entity's entity metric for the purposes of calculating the entity's ASIC Supervisory Cost Recovery Levy, imposed by the *ASIC Supervisory Cost Recovery Levy Act 2017.*

We highlight the important of ensuring these are appropriately addressed.

Further, most RLs work in small businesses themselves – small one to three partner businesses which are, generally, not highly profitable (liquidators earn up to 30% less than their equivalents in tax or audit). These small firms also deal with the vast majority of SME insolvencies in Australia. They are also those affected the most by the IFM.

As you will be aware, COVID-19 has dramatically worsened the insolvency market with many insolvency firms now in significant financial distress themselves. It is also important to note that insolvency practitioners are the major providers of business restructuring advice and will form the core group of professionals best placed to implement these new reforms from 1 January 2021.

However, RLs will also have to pay the amount of the ASIC IFM for the 2019/20 financial year in January 2021. It is expected to cost upward of an average of $14,000 per liquidator but may vary from $5,000 to upwards of $40,000. Liquidators remain unsure exactly how much they owe because the metrics have still not been finalised.

Other registration and industry fees have been waived during this period. We strongly advocate to Treasury and Government to temporarily waive the IFM fees for RLs for the previous and current financial years.

Committee process

The Registration Committee currently this committee comprises of a representative for the Minister, a representative of ASIC and a representative from the insolvency profession nominated by ARITA. We understand that the relevant pools of representatives in some instances are very small. Given the critical role this committee will play in the registration of registered liquidators and new restructuring practitioners, it will be essential for the pool of suitably experienced and skilled representatives to be sufficient to handle the anticipated increase in registration applications.

We suggest ASIC be given a role to undertake an initial vetting of applications to determine whether applicants meet the minimum criteria as specified in the rules. This would ensure only potential applicants are then interviewed through the committee process to avoid unnecessary cost and process for those whose registrations would not be suitable.

ATO influence

Given related creditors are not entitled to vote and secured creditors are only entitled to vote to the extent that they are unsecured, it is therefore not inconceivable that the actual vote being considered for acceptance is based on creditors with value much less than $1,000,000. We also consider it highly likely that the ATO could represent a significant portion of that voting value.

This would place a very high responsibility on the ATO to consider and respond to voting within the 15 day period on a large number of small business restructuring requests. This would significantly increase the workload for the ATO, who would need to be appropriately resourced to respond to these requests in a timely manner. We also consider there is the potential that the ATO's decisions regarding the plans and remuneration could become central to the entire process.

Appendix B

Why choose a Chartered Accountant?

Across the country, in local communities and large cities, Chartered Accountants are seen as a trusted and educated group of financial professionals who are working every day to serve the interests of all businesses in the Australian economy.

This is a result of:

Being highly qualified

As well as relevant degree-level study, all our members have completed a minimum of three years approved and mentored relevant work experience. Chartered Accountants have a TEQSA approved AQF8 post-graduate qualification which requires long hours of rigorous study.

Significant continuing professional development obligations

Significant on-going professional development requirements ensure Chartered Accountants skills and knowledge remain current and relevant. Members are required to complete a minimum of 120 hours of relevant training during a three year period. This is monitored through audits for a selection of members as well as annual declarations from all members.

Broad experience

Our members are accountants who can offer far more than technical knowledge. Chartered Accountants are broadly experienced in dealing with business and financial issues across a diverse range of management and advisory roles. This bigger picture holistic perspective enables them to work flexibly to positively impact businesses, organisations and communities.

Fully accredited

Our members have all met, and are bound by, internationally recognised technical and ethical standards. Chartered Accountants ANZ is part of the Global Accounting Alliance - the coalition of the world's premier accounting bodies.

Future-focused

Whether working in business or practice, Chartered Accountants are uniquely positioned to offer advice that can be trusted. Through deep understanding they have the skills to examine the past and guide organisations into the future.

Highest ethical and professional standards

Members are required to adhere to a strict code of ethics included in the Accounting Professional & Ethical Standards Board's Code of Ethics for Professional Accountants (including Independence Standards) (APESB 110). They are also required to comply with detailed CA ANZ regulations which maintain high levels of professional standards.

Protection to consumers and members through the Professional Standards Scheme

All members in public practice must meet the requirements of the CA ANZ Professional Standards Scheme. This includes having minimum levels of professional indemnity insurance and appropriate disclosure of the limitation of liability under the scheme. This offers protection to both our members and their clients.

Quality Review Program

The Chartered Accountants Quality Review Program reviews practices on a cyclical basis and examines each practice's compliance with technical and professional requirements, including compliance with the professional standards scheme. The programme monitors whether our members in public practice have quality control systems in place to ensure they comply with the Code of Ethics, professional standards, and legal and regulatory requirements. All members offering services to the public are eligible for review. This helps maintain a consistently high standard of quality and service to their clients.

Conduct and disciplinary processes

There are robust disciplinary processes to hold members to account who may not comply with high professional and ethical standards. This includes investigating and resolving complaints made against members. Sanctions imposed on members can include termination or suspension of membership, a reprimand, training and costs.

Appendix C

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand (CA ANZ) represents more than 128,000 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.