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Dear Ms Carnell

## **Submission to Australian Small Business and Family Enterprise Ombudsmen Business– Insolvency Practices Inquiry**

### **Introduction**

The Australian Credit Forum (**ACF**) welcomes the opportunity to make a submission to the Australian Small Business and Family Enterprise Ombudsmen in respect of the Insolvency Practices Inquiry and the Insolvency Practices Inquiry Discussion Paper.

The ACF was established in the early 1970's by a group of senior credit professionals. The group recognised the need to develop an association where members could meet on a regular basis to exchange thoughts and ideas to strengthen their own knowledge but also the standards of the industry.

The association meets on a regular basis to discuss and review existing and proposed changes to the Federal and State Governments legislation that might have an impact on their company's credit policies and practices in their day to day role as credit professionals.

The members of ACF are drawn from all areas of the credit profession across a range industry groups including by not limited to senior credit managers, members of the legal profession, insolvency practitioners, credit insurance underwriters and brokers, mercantile agents and credit reporting agencies. The depth and diversity in experience of the members ensures that a broad cross section of the credit industry considers the impact of all relevant legislation.

### **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?"*

The ACF considers the information with respect to the formal insolvency process should be simplified. Within the industry, illegal phoenix activity is a major problem, which could potentially be stopped if small businesses are provided with simplified information on how to deal with insolvency and insolvent trading. It is estimated that phoenix activity costs the Australian economy between \$2.85 billion and \$5.13 billion every year.<sup>1</sup>

In relation to insolvent trading ASIC reported possible insolvent trading in 71% of reports or 5,350 instances during July 2018 to June 2019 (up from 69% or 5,264 instances in the prior year.<sup>2</sup>

There is scope for a body similar to the ASBFEO Tax concierge service<sup>3</sup> to assist small businesses, on the basis that there can be vast differences in insolvent businesses and during this time, the directors are likely to be under a great deal of stress.

A benefit of this maybe helping businesses understand that an outcome is appropriate considering the legislation and conditions and the small number of cases where in appropriate conduct of an insolvency professional. This would enable ASIC to act earlier.

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?”*

Liquidators and administrators play an important role, including but not limited to:

- (a) Ensuring the wind up is conducted in an orderly fashion;
- (b) Identifying breaches of duties by the directors; and
- (c) Seeking that a return to creditors is maximised.

If the remuneration and expenses were to be limited or capped, this may limit the effectiveness of the roles that are to be played by liquidators and administrators. Notwithstanding this it is important that creditors are still given power and opportunity to challenge remuneration, fees and disbursements and fees to make sure the insolvency process is reasonably and fairly completed.

The ACF recommends, as an alternative to restricting or capping costs and remuneration, reducing the burden of regulatory requirements may reduce the basic costs associated with an insolvency. If these basis costs are reduced, then it will allow for a greater return for the creditors. Further, ensuring that the insolvency professional keeps creditors informed, the whole process is likely to be more effective, and ad hoc costs will be reduced.

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?”*

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<sup>1</sup> <https://www.ato.gov.au/General/The-fight-against-tax-crime/Our-focus/Illegal-phoenix-activity/The-economic-impact-of-potential-illegal-phoenix-activity/>.

<sup>2</sup> <https://download.asic.gov.au/media/5416956/rep645-published-18-december-2019.pdf>.

<sup>3</sup> <https://www.asbfeo.gov.au/assistance-concierge-service>

There may be scope for such information, but given the uncertainty that is associated with litigation and the numerous variables and different circumstances for each insolvency, these fees may not always be relevant. The key factor is whether the fees were incurred for a reasonable purpose, so the average costs may not be entirely useful.

The ACF recommends that instead of detailing “average costs” a remuneration report should detail and explain:

- (a) the work that has been done;
- (b) what was achieved;
- (c) the cost of the work; and
- (d) the future milestones.

The above approach is the approach detailed by Thea Eszenyi Senior Executive Leader, Insolvency Practitioners, Australian Securities and Investments Commission in the July 2019 article in Credit Management in Australia.<sup>4</sup>

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 and owners?”*

While it is important for creditors to be provided with access to information about the insolvency, it is more important that creditors are provided with clear and relevant information. The ACF opines that the more reports are provided (while they may be useful) may actually create additional work and additional fees, which may actually reduce the return to creditors.

The ACF considers that the more important reports that should be provided to creditors include ASIC alerts when reports are in fact not being lodged. This will alert creditors to the fact that the administration is not being conducted properly, which may in time, result in a benefit to creditors.

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

The ACF recommends that as opposed to seeking approval prior to attempting to realise an asset, it would be more beneficial to engage in a “post sale” reporting process. This is because a liquidator’s bargaining position may already be disadvantaged due to the nature of the sale.

Any additional disclosure prior to the sale may hinder and not assist the liquidator and it may have detrimental effects for the creditors and the realisation of the asset itself.

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<sup>4</sup> [https://aicm.com.au/files/1815/7594/0915/AICM\\_Iss\\_5\\_July\\_2019\\_p25-28\\_-\\_Thea\\_Eszenyi\\_-\\_Fair\\_pay\\_for\\_fair\\_work.pdf](https://aicm.com.au/files/1815/7594/0915/AICM_Iss_5_July_2019_p25-28_-_Thea_Eszenyi_-_Fair_pay_for_fair_work.pdf).

A post sale report would ensure that the liquidator is not effected by having to seek creditor approval, and the creditors also benefit by having a clear and simple report to consider, that would detail any assumptions relied on by the liquidator (such as book value), along with other factors that effected the sale. It would also give creditors a clear avenue to seek further clarification or be referred to ASIC for further review if necessary.

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?”*

The ACF supports this recommendation for the following reasons.

An absence of adhering to the requirement can be detrimental and unfair to creditors because:

- (a) Receiving demands for significantly inflated values to provide a significant bargaining position;
- (b) Issuing demands where there is a clearly valid security interest registered on the PPSR;
- (c) Time spent reviewing archives, contacting past employees and responding to claims;
- (d) Recoveries being absorbed by legal fees incurred in pursuing the unfair payment.

It does not seem fair to ACF members who have simply used best practice credit and collection management practices that they are required to return monies recovered when rarely that are distributed to the creditors of the liquidation.

In addition, the ACF recommends the following.

- (a) The time frames related to preference claims are reduced for:
  - (i) payments subject to preference claims from 6 months to 3 months prior to the point of insolvency; and
  - (ii) the time liquidator to bring a claim following their appointment from 3 years to 12 months.
- (b) Certain definitions are amended as follows.
  - (i) The definition of *“suspicion or reasonable grounds to suspect insolvency”* should be changed to requiring actual knowledge of insolvency.

Currently, if a creditor has “*suspicious*” or should have suspected that a customer is insolvent, then it lends itself to a preference claim against the creditor. Further, many credit professionals are employed to suspect insolvency, notwithstanding that the customer may display signs of insolvency, without actually being insolvent.

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 before being eligible for appointment?”*

The ACF supports this recommendation. Purely from a legal standpoint, it is important that directors are fully aware and understand the numerous duties and responsibilities that are associated with being a director of a company. Such core education would and should also focus on good corporate governance, and how to financially manage a company.

Numerous other benefits from such an approach include:

- (a) Ensuring there is clarification around the concept that a company is its own legal entity and the fact that personal liability of the director is protected; and
- (b) Helping to minimise the instances of illegal phoenix activity and the impact it has on the Australian economy.

The more core education prospective directors have on running a business and the potential risks of being personally liable for things like voidable transactions; can only benefit the industry as a whole, including the directors themselves.

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 business?”*

The ACF supports this recommendation for the same reasons as listed for question 7 above.

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) *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. “*

The ACF supports this recommendation to the extent that the person providing the information should only be provided by a qualified and/or registered accountant, lawyer or insolvency practitioner.

However, in the cases where an illegal phoenix advisor is providing the information, significant penalties should be required so as to avoid their costs being seen as a cost of business.

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?”*

With the exception of not requiring directors to seek advice of an advisor with appropriate insolvency qualifications, the ACF considers the current regime is largely appropriate. The absence of expert knowledge brings an increased risk of plans failing, with a flow on effect of creditors potentially being exposed to greater risk.

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

The ACF considers and recommends that accountants can best support small businesses by simply being educated on the need to refer the small businesses that are experiencing financial difficulty and that may be close to, or insolvent, to a registered insolvency professional.

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?”*

Given financial counsellors are assisting individuals; they should be well versed in the areas relating to bankruptcy.

The ACF considers that it would be beneficial for financial counsellors to have an understanding of corporate insolvency, as well as bankruptcy, to the extent an individual should be aware of the process, and what to do about the situation.

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

The mental health of small business owners and directors is an important consideration, however making it cause for a pause in the proceeding may only result in greater stress on the individual and to the creditors given it important to ensure the timeliness of the process is not adversely impacted.

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

The ACF does not claim to have any expert knowledge in the area of mental health, the ACF considers that clear and simple communication may reduce the stress associated with the process. In circumstances where business owners and directors (who may not be familiar with the technical language) are experiencing massive upheaval, having clearly laid out information that is easy to digest may have a small positive impact.

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.”*

As a general submission, the ACF recommends that processes for small business and insolvencies generally are simplified, with a view of:

- (a) reducing unnecessary costs;
- (b) increasing an overall return to creditors; and
- (c) identifying breaches of directors' duties.


It is imperative that there is transparency in the process, and in a simple and clear way. Therefore, the ACF does not support the use of pre-packs or other arrangements that have pre-determined outcomes. It is important that creditors are provided an opportunity for overview, especially where significant losses arise.

Prepared by;

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On behalf of the Australian Credit Forum.



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