ASIC

Australian Securities & Investments Commission

The view from ASIC: a perspective on current activities and enforcement powers

An address by Professor Berna Collier, Commissioner, Australian Securities and Investments Commission to the Practical Insolvency and Practice Management Conference 2004, 15 March 2004.

I am delighted to have again been invited to speak at this conference. It is hard to believe that it was only this time last year I spoke about the recent formation of ASIC's National Insolvency Coordination Unit (NICU). So much has happened in relation to insolvency at ASIC since then.

NICU was established to help coordinate ASIC related insolvency activity. Over the past year it has expanded from 2 to 12 permanent specialist insolvency staff, as well as 6 senior secondments from the insolvency profession. Many of them are here today.

Last year the Federal Government recognised the importance of ASIC's insolvency activities by providing additional funding of $12.3 million over four years for this

work. We believe that this is money well spent, as evidenced by the results we have been getting. I will be discussing some of these results during the course of this presentation.

One thing we have been very keen on has been a deliberate strategy of communicating with the insolvency profession. We have held regular regional liaison meetings with senior insolvency practitioners and lawyers which have been valuable to ASIC by allowing us to keep in close touch with current issues in the profession and gauge industry views about the areas that are most in need of policy guidance. Our attendance at this conference, both by presentations such as this and by our people coming along to join you, are part of our endeavour to stay in touch with you. We welcome the opportunity to do so here, and look forward to our conversations with you over the next two days.

The key focus of my presentation today is our current insolvency activities and enforcement powers. In this paper I propose to:

1. Discuss ASIC's national insolvent trading program and some of its results;
2. Update you on the work of our Complaints Compliance Action program in providing assistance to liquidators;
3. Make some observations on insolvency practitioners' reporting obligations and ASIC's electronic lodgement project EXAD;
4. Talk about ASIC's role as regulator of the insolvency profession, including our Insolvency Practitioner Regulation Project and Policy Statement 33 Compliance Project;
5. Note ASIC's other current insolvency activities; and
6. Discuss some practical issues of relevance to liquidators when ASIC commences a formal investigation over companies to which they are appointed.

1. ASIC's new approach to insolvent trading

Last year I spoke to you about ASIC's six month pilot program in Sydney and Melbourne established in January 2003 to conduct reviews of companies suspected of trading while insolvent. Well, it is no longer a pilot. The success of the program and the additional funding from the Federal Government for our insolvency initiatives led to the confirmation of the strategy and the establishment of a national program in July 2003 to continue this work.
The program aims to:

- Make company directors aware of their company's financial position
- Make directors of potentially insolvent companies aware of their responsibilities and the implications of continued trading if they know they are insolvent
- Encourage directors to seek external advice from accountants and lawyers on restructuring, and
- Encourage directors to seek advice from insolvency professionals, where appropriate, and to take action to appoint a voluntary administrator or liquidator where necessary.

As you will only be too aware, there is too often a culture of denial of financial difficulties by company directors. ASIC hopes that the program will go some way to changing this culture and having directors take early action where necessary to rectify those difficulties. This will maximise the chances of a company surviving. Frankly, it will also minimise the loss to creditors if the directors recognise the reality of a situation and act early to appoint a voluntary administrator or liquidator. Correspondingly, it will also hopefully see an increase in the assets available to creditors and in funds available for the external administrator to carry out their investigations.

So – what are the results of the program since it went national?

From 1 July 2003 to 29 February 2004:

- Surveillance visits of 399 companies (including a number of related companies) were conducted
- 40 companies appointed a voluntary administrator or liquidator following a visit
- Updated or additional financial information was sought from 154 of the companies visited
- Restructuring advice was sought by the directors of a number of companies visited.

These results would not have been achieved without the assistance of the profession. Deloittes, Ernst & Young, PriceWaterhouseCoopers, KPMG, Ferrier Hodgson and PPB have provided senior manager secondments to support ASIC's own senior insolvency staff. The benefits to the development of seconded staff include wide exposure from carrying out reviews of a large variety of companies over a six month period and a better understanding of the issues facing the corporate regulator.

If you are interested in seconding one of your senior managers to the program you can obtain further details from the Director of NICU, Stefan Dopking, who is here today.

The review process

So – how do we go about selecting a company for a review under the program?

First, let me make it clear that it is not a random decision. We use a number of sources to select companies for financial review under the program, including:

- Complaints we receive from the public, including complaints from accountants, credit managers and company employees
- Listed companies that had their annual accounts reviewed as a part of our accounts surveillance program and were identified as financially stressed.
- Information from liquidators, and

- Referrals from other areas within ASIC.

Once a company is selected for review we build its profile. This includes credit reference checking, checking ASIC's intelligence sources, media searches, profiling its industry and talking to the complainant, if applicable.

We then phone the company director to make an appointment to visit them. This is followed by the service of a formal notice requiring the company to provide relevant books and records at the visit. The review usually takes place at the company's principal place of business.

Most of the books and records requested will normally be retained by ASIC officers and returned at a later date. Usually copies of documents are sufficient but sometimes it may be necessary to take the originals. You should bear this in mind if you are appointed to a company that has been subject to an ASIC review, as we may be in possession of records you could be interested in.

The Managing Director usually attends a review to help explain the company's business. We also encourage the company's external accountants, as well as other directors and finance staff to attend.

If we have concerns about a company's potential insolvency after our review we will write to it setting out those concerns. If we find the company's books and records are not up to scratch we may ask it to prepare up to date management accounts to assist in assessing its financial position.

Where appropriate, we may suggest that the company approach an insolvency professional for advice on the possible appointment of an external administrator. At the same time we strongly encourage directors to seek professional advice from their accountant and/or solicitor to ensure compliance with their duties under the Corporations Act.

Our approach aims to have directors take the necessary steps themselves. If they don't, then ASIC will pursue its own action. A recent illustration of this was the Budget Lifestyle Homes matter, where ASIC took action to wind up a NSW building company under the program. The director had told ASIC following a review visit that he would arrange for a voluntary administrator to be appointed. He then disappeared without doing this, leaving behind unpaid creditors. He didn't do anything to deal with this obviously insolvent company, so we did.

Companies that appointed an external administrator after an ASIC visit include Victorian speed camera company Poltech International Ltd, Feature Australia Pty Ltd (trading as Feature Tours) and the Wagga Leagues Club Ltd.

I am also pleased to report that in several cases companies have significantly improved their financial position as a result of seeking professional advice and restructuring following ASIC's visit.

This approach to dealing with insolvent trading is in addition to, not instead of, our criminal and civil action against directors under the insolvent trading provisions of the Act.

265 charges of insolvent trading against two directors of Tasmanian baby furniture manufacturer Cotech Pty Ltd are to be heard in the Tasmanian Supreme Court this year. ASIC alleges that the directors failed to prevent Cotech from incurring debts of $261,901 when the company was insolvent.

Educating the accounting profession

It has become apparent to ASIC from the program that some company directors are not receiving proper advice from their external accountants on their obligations when their company shows signs of possible insolvency. To help counter this, articles on the program and how accountants can help prevent insolvent trading are to be published in the March and April issues of the CPA Australia magazine. A shorter

article setting out how ICAA members can help was included in February's CA Local News.

We are also currently working with CPA Australia on a course it intends to deliver in each capital city from June this year. This will be aimed at educating its members on the duty of directors to avoid insolvent trading, the implications if they don't and the role of accountants in assisting their director clients to comply with their obligations. Issues it will cover include assessing when a company is or about to become insolvent, key indicators of insolvency and the defences to insolvent trading.

2. Assistance to liquidators

Another of ASIC's insolvency initiatives, aimed at assisting liquidators is now well into its second year. Our Complaints Compliance Action (CCA) program to address misconduct by company officers, including failure of directors to assist liquidators by, for example, not providing books and records or reports as to affairs, continues to have pleasing results and positive feedback.

A key indicator of the success of the program is that in the 8 months to the end of February 2004, 51% of company officers contacted by ASIC chose to comply before we needed to prosecute. Other results for the period are:

- 246 company officers were prosecuted for 501 offences under the Corporations Act, including 372 offences involving failure to assist liquidators, e.g. by not providing reports as to affairs or not handing over books and records.
- These prosecutions resulted in $369,621 in fines and costs against those company officers.

Significant results include:

- A 3 year gaol sentence
- A 1 year suspended gaol sentence

- 3 arrest warrants
- 4 good behaviour bonds
- 4 community service orders

Presently before the courts are another 164 individuals facing 194 charges (152 involving failure to assist liquidators) and another 176 like matters are currently being investigated.

3. Reporting obligations for insolvency practitioners

There are several areas relating to the reporting obligations of insolvency appointees that I wish to touch on today.

Policy Statement 174 – Externally administered companies: financial reporting and AGMs

The first relates to the financial reporting and annual general meeting (AGM) obligations of externally administered companies. In June last year ASIC released an interim policy, Policy Statement 174 covering this issue, following extensive consultation.

ASIC's view is that companies which become externally administered are still required to lodge and prepare financial accounts. This is because the legal obligations are on the company, not on the directors. The interim policy statement aims to ensure that external administrators are aware of their obligations under the Act and to assist externally administered companies to decide when an application for relief may be appropriate.

A Class Order [CO 03/392] was also issued which exempts companies in liquidation from the financial reporting obligations in Part 2M.3 of the Act, and grants certain other externally administered companies an extension of time in which to comply with these obligations.

I suspect that some of you may not be entirely happy that the policy does not exempt all companies in external administration from the financial reporting obligations. The decision on the form of the policy was not an easy one. In reaching our position we have sought to achieve the difficult task of balancing the competing interests of those who seek financial information about a company and those who bear the costs of providing this information when a company is in external administration. We will review our policy when we have more experience with a wider range of applications for relief under the policy.

ASIC's experience to date has shown that many external administrators are either still not familiar with the policy and class order or are not taking the necessary steps to seek an extension of time to lodge the company accounts or to defer these obligations.

Our Policy and Markets Directorate is currently conducting the national Accounts Non-Lodgement Project. This is designed to detect and take action against listed disclosing entities which failed to lodge their half and full year financial reports. The project has identified a number of companies in external administration which were either late or non lodgers of the required financial reports for the full or half year ended 30 June 2003.

- 4 externally administered companies that were entitled to rely on the extension of time provided in Class Order 03/392 failed to lodge the required notice of reliance on the Class Order with ASIC.

- 21 externally administered companies that were not entitled to the benefit of the Class Order did not lodge accounts within time or make applications for individual relief for the year ended 30 June 2003 within time.

We cannot grant relief to cure a past breach of the financial reporting and AGM provisions of the Corporations Act. However, we may grant relief for a prospective or continuing breach.

ASIC has the power to issue determinations under section 713(6) of the Corporations Act against those companies that fail to meet their obligations under Chapter 2M. The effect of issuing one of these determinations is that the company concerned cannot issue a shorter form section 713 prospectus. It would be required to issue a full prospectus if it wishes to undertake any fundraising during the period covered by the order. The company's ability to make placements may also be affected by the making of the determination.

We are currently considering whether to issue determinations against those externally administered companies identified under the project.

External administrators and their professional staff are urged to:

- read Policy Statement 174 to ensure they are aware of their obligations; and
- where necessary, take prompt steps to notify ASIC of their intended reliance on Class Order 03/392 or make an application for individual relief in relation to a company over which they are appointed.

A copy of Policy Statement 174 is available from ASIC's website www.asic.gov.au

Administrators' 439A reports

I would also like to comment on what ASIC expects of administrators in preparing their section 439A reports. This report is the cornerstone of the Voluntary Administration process and ASIC expects it to be of the highest standard. It must contain all information about a company's circumstances that is material to creditors in making an informed decision on the future of the company. This is particularly crucial where a Deed of Company Arrangement is proposed.

More than 10 years after the introduction of Part 5.3A, numerous court decisions and published articles later on what is required in administrator's reports, ASIC is still coming across reports that don't meet this standard. Three liquidators are currently being investigated in relation to conduct that includes inadequate section 439A reports with a view to referrals to the Company Auditors and Liquidators Disciplinary Board.

In the National Investment Institute Pty Ltd administration, ASIC recently made an urgent application which resulted in a Court order that the administrator not propose any resolution at the section 439A meeting other than one to adjourn the scheduled creditors meeting. Our action was prompted by concerns that the administrator had not provided sufficient information in his report explaining the company's financial circumstances and the Deed proposed by Mr Henry Kaye.

Specifically, ASIC considered that the administrator's report did not :

- Adequately set out the details of the DOCA proposed by Mr Kaye as required by the Corporations Act;
- Adequately report on whether National Investment Institute Pty Ltd may receive or be entitled to all or part of the proceeds of sale of a number of properties and developments owned by companies controlled by Mr Kaye;
- Indicate whether a claim by another company controlled by Mr Kaye to have priority for a debt of $6.8 million was valid;
- Adequately explain either the legality or effect of an agreement entered into two days prior to the administrator's appointment, by which security over properties and developments owned by companies controlled by Mr Kaye was granted to a third party.

I note that in its recent submission to the CAMAC review on the restructuring of large and complex enterprises, the IPAA suggest that it might be appropriate for the Corporations Act to require administrators to provide full disclosure in their report of the effect on priority creditors where section 556 is not going to be followed under a Deed. This is relevant to employee creditors who are not eligible to claim under the General Employees Entitlements and Redundancy Scheme where a Deed of Company Arrangement does not follow the section 556 priorities. In ASIC's view, administrators are already required under the existing law to provide this information in their reports to creditors. ASIC also expects that in cases where a Deed of Company Arrangement proposes to vary the priorities, in giving their views on

whether creditors will get a better return under the Deed than under a winding up, administrators will in their report identify in dollar terms, and take account of, the return employees are entitled to under GEERS in a winding up. This should be compared to their likely return under the proposed Deed.

ASIC will continue to refer practitioners who prepare inadequate section 439A reports to the Company Auditors and Liquidators Disciplinary Board.

Electronic lodgement

The final matter I want to mention about the reporting obligations of external administrators is ASIC's project dealing with the electronic lodgement of insolvency forms.

I am pleased to report that the level of electronic lodgement of reports under sections 422, 438D and 533, known as Schedule B reports, reached 71% in January 2004. This dropped back to 58% in February 2004 but we are hopeful that it will soon recover in line with the average for the last 3 months of 66%.

We are currently considering issuing a paper Schedule B (Form EX01) to enable us to capture the same information as for the electronically lodged forms. The detail collected will be the same as on the electronic form, but you'll have to complete full details of the company on which you're reporting, so it will be much easier to lodge electronically.

The electronic uptake of notifications of appointments and cessation of appointments of external administrators, as well as changes to the Registered Liquidator Register have been slower to take off. I urge those of you who haven't taken the plunge to move to electronic lodgement – feedback from users has been favourable. Some of you may have been waiting until more insolvency forms were lodgeable on line. The good news is that a further five forms will be available electronically later this month.

These are:

Form 5011 Minutes of meeting*

Form 523 Notice of final meeting convened by a liquidator

Form 529 Notice of meeting

Form 509D Notice of special resolution to wind up a company, and

Schedule A to Practice Note 50 – reports lodged under s476 of the Corporations Act 2001 (recorded in our public database as Form 564).

** This Form will replace Form 911 for electronically lodged minutes of external administration meetings.*

The first three forms will allow you to attach and lodge documents from your own database and to scan in minutes lodged by you but signed by others.

We intend to add more insolvency forms during 2004.

4. ASIC as a regulator of the insolvency profession

Insolvency practitioner regulation project

ASIC takes its role as regulator of the insolvency system very seriously. As a part of our increased focus on insolvency, late last year we started a thorough review of insolvency practitioner regulation – called the Insolvency Practitioner Regulation Project. The review will include consideration of the requirements for gaining and maintaining registration as a liquidator, surveillance of the industry and methods for sanctioning misconduct within the industry. Before starting the project, we sought input from our regional insolvency meeting groups on the types of issues that should be considered.

As part of this project we have considered elements of regulatory frameworks in other jurisdictions. At this point ASIC is not advocating the adoption of these ideas, but we are turning our minds to whether they are desirable features. These include:

- Whether applicants for liquidator registration should be required to complete some type of insolvency specialist training;
- Abolition of tiers of liquidator registration or a reclassification of the tiers so that the higher tier applies to more complex and difficult work. Allied with this is a consideration of criteria for progression to the higher tier;
- A requirement to have and maintain human, financial, technological and organisational resources sufficient for the type of appointments undertaken by the registrant;
- The introduction of ongoing obligations either expressed in law or by conditions placed on a licence to practice;
- Whether there should be a code of conduct for the profession which has legislative backing; and
- Whether there should be some grounds triggering automatic suspension of registration.

A policy proposal paper will be released later this year. When it comes out, I strongly encourage you to take the time to read it and provide us with your feedback when the time comes. As is clear from our interim policy on the financial reporting and annual general meeting obligations of externally administered companies, we do seriously consider comments we receive on proposed policy.

Policy Statement 33 Compliance Project

Another regulatory activity ASIC has been carrying out is a review on compliance with ASIC Policy Statement 33, dealing with liquidators' security deposit requirements and alternative professional indemnity insurance arrangements. This Policy Statement was amended in June last year to reflect the reduced professional

indemnity insurance requirements of the Institute of Chartered Accountants in Australia (ICAA) for its public practice members.

We subsequently started the compliance review to ensure that all liquidators relying on the professional indemnity insurance alternative were complying with the policy. From 27 June 2003 to the end of February 2004, 86 'cessation as liquidator' forms were processed. We are currently taking action to instigate referrals to the CALDB, of those practitioners who have not provided evidence of compliance.

This exercise has highlighted that, despite the large number of cessations, there are undoubtedly registered liquidators out there who have not practiced in this role for sometime. The issue of the lack of obligations under the Corporations Act to maintain experience is one that we are examining as part of our Insolvency Practitioner Regulation project that I mentioned earlier.

CALDB

As you are aware, the Company Auditors and Liquidators Disciplinary Board carries out the disciplinary role in the regulation of liquidators. I would now like to briefly run through the changes to its structure proposed under the CLERP 9 Bill currently before Parliament.

The Bill provides that the new Board will comprise fourteen people, instead of the current three. These will be the Chairperson, a Deputy Chairperson (both of whom must have legal qualifications), three ICAA members, three CPAA members and six members from the business community. The latter must have qualifications, knowledge or experience in business or commerce, the administration of companies, financial markets, financial products or services, economics or law.

The Board itself will no longer conduct hearings. Instead up to two Panels, chosen from the overall membership of the Board, will sit under the Board and hear matters. This will allow both Panels to sit at any given time and thereby hear and determine matters more expeditiously.

A Panel will normally consist of five persons including: the Chairperson or Deputy Chairperson, one member each from ICAA and CPA and two members from the business community. Allowing for a majority of non-accountants on each panel is aimed at enhancing the perceived independence of the Board.

The proposed amendments will also authorise the release by the Board of relevant information to the professional accounting bodies and other prescribed professional bodies, to assist them in their disciplinary activities. Examples of other bodies given in the explanatory memorandum include a legal professional body or an insolvency body.

5. Other current insolvency activities

I am currently representing ASIC on the Corporations and Markets Advisory Committee review into rehabilitating large and complex enterprises. CAMAC is expected to report this year.

ASIC is also helping implement the Government's response to the Cole Royal Commission recommendations on phoenix company activity. Our involvement includes:

- Participating in the Cole Inquiry working party formed by the Government, to consider amendments to relevant legislation to permit information exchange between ASIC and the Australian Taxation Office.
- In conjunction with Insolvency & Trustee Service Australia (ITSA), we developed measures to have people listed on ITSA's National Personal Insolvency Index checked against our company database (called ASCOT) to

identify bankrupts appointed as directors. This electronic process is now up and running.

- We are presently considering our response to Treasury on appropriate procedural and/or legal reform to identify companies without directors.

Treasury is currently considering our proposal to replace existing Forms 508 and 524 with the revised draft Form 524X (six monthly accounts and statement). They are also examining whether to take insolvency forms out of the regulations and convert them to ASIC approved forms.

6. Practical issues when ASIC commences an investigation

I would like now to touch on some practical issues that arise when ASIC commences a formal investigation into a company to which a liquidator is appointed.

When a formal investigation is commenced under section 13 of the ASIC Act, we can require a person to appear and give information relevant to the investigation and require reasonable assistance to be given (section 19 ASIC Act). We can also issue a section 30 notice requiring a company and eligible persons to produce books relating to the affairs of the company. Eligible persons include external administrators.

ASIC usually requires original documents to be produced, particularly where criminal or court proceedings are the likely outcome of its investigations. We will always try to image original documents and return copies of the documents as soon as possible if the insolvency practitioner requires them for their investigations. You should discuss this with the ASIC investigator.

We may ask insolvency practitioners to waive legal professional privilege enjoyed by the company, but obviously not that enjoyed by the directors of the company. In most cases where the issues relate to the period prior to the commencement of the external administration, our experience is that liquidators will waive privilege to enable evidence to be lead in a criminal prosecution

What about documents the subject of legal professional privilege enjoyed by the insolvency practitioner but which may be required to be produced pursuant to the notice? The liquidator will need to discuss these issues with the investigator on a case by case basis.

It is important for you to be aware that ASIC has an obligation to provide to the DPP all material produced to us that may be relevant to the defendants' defence in a criminal trial. The DPP must also comply with obligations of disclosure to defendants.

Where ASIC requires evidence to enable company records to be admitted, or indeed, evidence regarding financial issues relating to the company, our investigators will generally draft statements from the documents already produced and from interviews/discussions with liquidators regarding issues relevant to the charges. The liquidator is then requested to settle and sign the statement. These statements will be prepared in a form which complies with the relevant legal and Court requirements in each jurisdiction.

The information flow isn't all one way. Some information ASIC obtains from its investigations may be available for liquidators. Where a liquidator is taking civil action, they may request a copy of ASIC's section 19 compulsory examination transcripts and related documents. This request should be made in accordance with section 25 of the ASIC Act and Policy Statement 103. An ASIC delegate will make a determination on the request. It may be that natural justice will be given to persons potentially affected if the transcripts are released.

On a slightly different matter, from time to time, ASIC will apply to wind companies up and will approach liquidators for their consent to act. You should be aware that ASIC will not normally indemnify the cost of the liquidation if there is a shortfall in assets realised.

Enforcement activity

I would like to finish by noting that ASIC currently has 46 current enforcement matters where either allegations of insolvency are being investigated or insolvency issues are related to the investigation.

During 2003 ASIC instigated 25 investigations arising from reports lodged by insolvency practitioners under sections 422, 438D and 533 of the Act. We are hoping to increase this during 2004.

Conclusion

ASIC has been very active in pursuit of its regulatory responsibilities relating to insolvency during the past year. This will continue in 2004. Some of our insolvency priorities for this year are:

- continuation of our National Insolvent Trading program and increasing the awareness of company directors of the need to take prompt action when their companies start to exhibit signs of financial difficulty;
- continuation of our Complaints Compliance Action program;
- completion of our Insolvency Practitioner Regulation project and publication of related policy guidance, following extensive consultation with the profession and other stakeholders;
- working more closely with the insolvency profession to assist them with their investigations into breaches of the Corporations Act; and
- taking action on more reports of offences from liquidators.