ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

23 October 2014

Mr Kyle Wright
Corporations
ASIC
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Brisbane Qld 4001

By email: policy.submmissions@asic.gov.au

Dear Mr Wright

Consultation paper 223: Relief for externally administered companies and registered schemes being wound up – RG 174 update

The Australian Restructuring Insolvency and Turnaround Association ("ARITA") represents insolvency practitioners and other professionals who specialise in the field of insolvency, restructuring and turnaround. We cover more than 2,000 members including insolvency accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency. ARITA's mission is to support insolvency and recovery professionals in their quest to restore the economic value of underperforming businesses and to assist financially challenged individuals. We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large. 76% of all registered liquidators and 86% of all registered trustees in bankruptcy are members of ARITA.

In most instances of applications for relief and deferral of financial reporting obligations under the Class Order [CO 03/392] and RG174, it is ARITA's members that are making the applications. On this basis, we are making this submission on behalf of ARITA members who therefore represent the vast majority of the users of the process.

As can be seen from our specific responses to the questions raised in the consultation paper below, ARITA largely supports Option 2 with some suggested modifications, which can be summarised as:

- That the deferral period for financial reporting can be for a period of up to 24 months on application rather than the proposed 12 months for both companies, schemes and responsible entities.
- Reconsideration of the role of a managing controller in financial reporting and responsibility for applications for deferral.
- The proposed new class order does not deal with the issue of deferrals of currently overdue financial reports. It is our view that there should be an automatic deferral of these

outstanding financial reports on the appointment of an external administrator until either the conclusion of the external administration or the appointment of a liquidator, whichever is the earlier.

- There should be clearer criteria established for schemes in relation to when the class order relief will be available and when a scheme will be eligible to apply for a deferral.

The role of managing controllers in financial reporting

ASIC has taken the position that managing controllers have an obligation to prepare financial reports under Chapter 2M. We disagree with that view and we raise the following points to support our position:

- Applications for relief from preparing financial reports under Chapter 2M pursuant to section 340(3) can only be made by the directors;

- ASIC's view is that a voluntary administrator can apply as they perform the functions and exercise any power that the company's officers could perform if the company were not in voluntary administration (s437A).

- ASIC recognises that this is not the role filled by controllers or managing controllers;

- At paragraphs 174.139 and 174.140, ASIC recognises that controllers without management power will not have the power to make an application for relief as the powers of a controller under section 420 do not extend to performing the functions and exercising the powers of a director;

- ASIC seeks to change this position for managing controllers in paragraph 174.141 by stating that when a controller is appointed over all, or substantially all, of the assets and has power of management, the managing controller and directors must work together when an application for relief is made;

- We disagree with this position as the powers for controllers and managing controllers under section 420 are the same – the Corporations Act does not differentiate. Therefore, managing controllers do not exercise any power that the company's officers could perform;

- It is well recognised that directors retain residual powers in a controllership – whether the controller has powers of management or not. For example, the directors can take action to challenge the validity of the controller's appointment. In our view, compliance with financial reporting obligations is a residual obligation of the directors;

- On 30 December 2007, section 421(2) was introduced to provide directors with the right to inspect the records kept by a managing controller or property of the company for the purposes of recording and explaining all transactions that the managing controller enters into. This gives the directors the required access to financial information that they need to comply with their financial reporting obligations;

- Therefore it is up to the directors to comply with the financial reporting requirements or apply for relief if they deem that relief is required.

In our view there is no statutory obligation on any form of controller, whether with management power or not, to comply with the financial reporting obligations under Chapter 2M. This is a duty

of the directors – and a controller is not a director. Only directors can make an application for relief under s 340(3), therefore this obligation also remains with the directors.

Response to questions from the consultation paper

The following table provides ARITA's responses to the questions posed in the consultation paper.

ASIC's Proposal	
We propose to consult on our approach to relief from the financial reporting and AGM obligations that apply to externally administered companies and registered schemes that are being wound up, and our proposed updates to RG174. We are considering the four options set out in paragraph 16. We recommend Option 2, and are therefore consulting in detail on this option.	
ASIC's Questions A1Q1 Which of these four options do you support and why? If you support Option 3, please explain which areas of our policy, in particular, should be tightened. If you support Option 4, please describe the additional relief you think we should consider providing and why. A1Q2 We want to understand the burdens faced by externally administered companies and registered schemes being wound up, including the costs that the company, scheme or others may bear in complying with the financial reporting and/or AGM obligations, and the costs associated with seeking relief from these obligations. We also want to understand the benefits of complying with the financial reporting and/or AGM obligations. How do you consider that these burdens and benefits may be affected by adopting Options 1, 2, 3 or 4? Please be as specific as possible, and include any estimates about the costs and resources required (e.g. time, personnel, external resources and expertise)	***ARITA's Comments*** A1Q1 ARITA supports option 2. Option 2 provides balance between the needs of external administrators and creditors of companies in administration, and the needs of shareholders where there may no longer be any value in the company. ARITA does have some comments and queries regarding the operation of option 2 and these are detailed below. A1Q2 We suggest that the deferral period be for up to 24 months on application. This will assist in reducing the number of applications that an external administrator will be required to make and the cost associated with those applications. If an external administrator is aware of circumstances that will mean a 24 month deferral period will be required, this should be able to be applied for immediately. There should be events specified which will end the deferral period – ie liquidation, or return of the control of the company to director.

<table>
<tr><td colspan="2">Issue

We want to hear your views on other issues in relation to the financial reporting obligations of externally administered companies and registered schemes that are being wound up.</td></tr>
<tr><td>ASIC's Questions

A2Q1

Are there any other policy considerations that may be appropriate for us to address in our regulatory guide? Please be specific.</td><td>ARITA's Comments

A2Q1

In relation to managing controllers, our view is that it is the directors' responsibility to prepare financial accounts and therefore apply for any deferral. This is discussed in detail above. However, if ASIC's position in respect of managing controllers does not change, greater guidance is needed on what the managing controller should do if the directors fail to co-operate or the directors have resigned, and what the consequences of the directors failure will be. For example, should the managing controller lodge the application for deferral anyway, noting that the directors have failed to co-operate? If this obligation is going to be imposed on managing controllers, we do not think it is appropriate that the managing controller suffer any adverse consequences as a result of the directors' failure. However, we reiterate our view that it is not an obligation of a managing controller to prepare financial reports, but rather it is an obligation that remains with the directors.</td></tr>
<tr><td colspan="2">ASIC's Proposal

B1

We propose to issue a new class order to replace [CO 03/392]. Our proposed new class order—Class Order [CO 14/xxx] Externally administered companies and registered schemes being wound up: Relief from financial reporting and AGM obligations—will provide the same relief as [CO 03/392], with the additional modifications proposed at B2–B7.</td></tr>
<tr><td>ASIC's Questions

B1Q1

Do you have any general comments and concerns about our proposed new class order? Please provide reasons supporting your comments.</td><td>ARITA's Comments

B1Q1

The proposed new class order does not seem to deal with the issue of extensions of time to lodge outstanding financial reports that may already be overdue at the time of the appointment of an external administrator. We note at para RG174.43 that there is a statement to that effect. We query what the</td></tr>
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	implication is of this to the external administration and suggest that the class order should apply to automatically place a deferral on these obligations until either the completion of the external administration or the company is placed into liquidation, whichever is the sooner.

ASIC's Proposal

B2

We propose to provide a class order exemption from the financial reporting obligations for registered schemes that are being wound up, where:

a) the scheme is insolvent (i.e. the scheme property is insufficient to meet the scheme liabilities to scheme creditors as they fall due);

b) the value of net assets of the scheme, determined in accordance with Australian accounting standards, is no more than $5,000 throughout the relevant financial year; and

c) ASIC has been formally notified of the commencement of the winding-up of the scheme.

We propose that, in these circumstances, we will also adopt a no-action position in relation to the responsible entity and its officers, or other person appointed by the court to wind up the registered scheme, for failure to comply with any provisions in the constitution of the scheme to arrange for a final audit of the financial statements to be undertaken.

ASIC's Questions	***ARITA's Comments***
B2Q1 Do you agree that the circumstances outlined above are an appropriate basis for ASIC to conclude that a registered scheme is insolvent, is being wound up and will ultimately be deregistered?	B2Q1 We question whether there is a need for the responsible entity, or the person appointed by the Court to wind up the scheme, to determine that the scheme is insolvent; as well as make a determination that the net assets of the scheme are less than $5,000 throughout the relevant financial year. Although the requirements are similar, they are not the same and in fact a scheme with less than $5,000 of net assets may, in fact, be solvent. *A determination as to insolvency should be sufficient and should be the only determination required.* We think that there is a lack of clarity around what "scheme's net assets" means and this is an issue for all references to "scheme's net assets" referred to in the consultation paper.

	There is no meaningful discussion of this in the RG, other than it must be determined in accordance with Australian Accounting Standards. This assumes that accounting records have been properly maintained and are available, which is not always the case and that the Standards result in a meaningful analysis of the solvency or otherwise of the Scheme. It also assumes that this is a relatively straight forward determination, which is also not always the case with complex MIS arrangements. The obligation is also to be below the limit of $5,000 throughout the relevant financial year, which could be difficult to declare with certainty due to fluctuations.
B2Q2 Do you think we should give class order relief to registered schemes in the circumstances outlined above? If not, are there any particular aspects of the proposal that should be amended?	B2Q2 Subject to our comments at B2Q1
B2Q3 Do you agree that we should not give class order relief to registered schemes that are being wound up where the scheme is 'solvent'?	B2Q3 Yes
B2Q4 Do you agree that we should take a no-action position in relation to the responsible entity and its officers, or other person appointed by the court to wind up the registered scheme, for failure to comply with any provisions in the constitution of the scheme to arrange for a final audit to be undertaken?	B2Q4 A no action position should be taken if the Scheme is being wound up due to insolvency.

ASIC's Proposal B3 We propose to clarify the scope of our class order financial reporting exemption for companies that have a liquidator appointed, so that: a) the exemption applies only to companies that are not AFS licensees; and b) relief is provided from any continuing obligations to prepare, lodge and distribute outstanding financial reports.	
ASIC's Questions	***ARITA's Comments***
B3Q1 Do you agree that our class order exemption for companies that have a liquidator appointed should not apply to AFS licensees?	B3Q1 Yes
B3Q2 Do you agree that our class order exemption for companies that have a liquidator appointed should extend to the outstanding financial reporting obligations and outstanding AFS licensee reporting obligations if the company has had its AFS licence cancelled?	B3Q2 Yes
ASIC's Proposal B4 We propose to provide a class order exemption from the obligation to hold an AGM to public companies that have a liquidator appointed where the company is also eligible for financial reporting relief under our class order.	
ASIC's Questions	***ARITA's Comments***
B4Q1 Do you agree that we should give a class order exemption from the obligation to hold an AGM to public companies that have a liquidator appointed?	B4Q1 Yes

ASIC's Proposal B5 We propose to extend our class order extension of time to the AFS licensee reporting obligations in Div 6 of Pt7.8, subject to conditions. Relief from the requirements in Div 6 of Pt 7.8 will not be available if ASIC has cancelled or suspended an AFS licence subject to a specification under s915H that requires ongoing compliance with the financial reporting obligations in Pt 2M.3 or the AFS licensee reporting obligations in Div 6 of Pt 7.8.	
ASIC's Questions B5Q1 Do you agree that we should extend our class order extension of time to the AFS licensee reporting obligations in Div 6 of Pt 7.8, subject to conditions?	***ARITA's Comments*** B5Q1 Yes
ASIC's Proposal B6 We propose to remove the requirement that a company notify ASIC that it is relying on the class order for an extension of time to report.	
ASIC's Questions B6Q1 Do you agree that we should remove the ASIC notification conditions for companies that rely on the class order for an extension of time to report?	***ARITA's Comments*** B6Q1 Yes
ASIC's Proposal B7 We propose to remove the condition in [CO03/392] that a company give notice in a daily newspaper of the alternative distribution method for its financial report, and instead require notice to be given on a website maintained by the external administrator.	
ASIC's Questions B7Q1 Do you agree that we should remove the newspaper advertising condition for the alternative distribution of financial reports?	***ARITA's Comments*** B7Q1 Yes, although we believe that the requirements that notice be given on a website "maintained by the external administrator" is too specific. We recommend notice be given by the external administrator on either the administrator's

	website, the company subject to administration's website or, if neither of those are available, a website administer by ASIC (for a nominal fee).

ASIC's Proposal

C1

We propose to cease giving individual financial reporting exemptions for externally administered companies, and to update our guidance in RG174 on individual deferrals to make it clear that:

a) we are generally likely to grant a deferral of all the financial reporting obligations (in addition to any previously deferred financial reporting obligations under our proposed class order relief or previous individual relief) for up to 12 months, where:

   i. the external administrator exercises all or most of the management functions and powers;

   ii. it is uncertain whether members have an ongoing economic interest in the company; and

   iii. if the company is subject to a DOCA and does not meet the above requirements—we are satisfied that the company should have additional time for other reasons;

b) we may grant consecutive deferrals of up to three months each where a controller (i.e. not a managing controller) has been appointed;

c) depending on the company's circumstances, we may also grant relief from some or all of any previously deferred financial reporting obligations, where the deferral has been ongoing for a long period of time and we are satisfied that the burden of preparing and lodging financial reports from the commencement of the external administration is disproportionate to the benefits; and

d) we are generally likely to grant a deferral of the reporting obligations in Div 6 of Pt 7.8 if the company is an AFS licensee.

ASIC's Questions	***ARITA's Comments***
	The proposal does not seem to deal with individual relief for deferrals of outstanding financial reports that may already be overdue at the time of the appointment of the external administrator. It is our view that there should be an automatic deferral of these outstanding financial reports on the appointment of an external administrator until either the conclusion of the external administration or the appointment of a liquidator, whichever is the earlier. This should be clearly dealt with in the updated RG174.
C1Q1 Do you agree that we should no longer provide individual exemptions for externally administered companies, and instead grant a deferral until it is clear whether a company will be wound up or deregistered? If not, why not?	C1Q1 Yes, however consideration should be given to allowing applications for deferrals for a period of up to 24 months, with the deferral period ending on a specified event, for example that the company returns to the control of directors. Furthermore, it should be made clear that if a company is subsequently wound up or deregistered that there will be relief granted for all financial reports for which deferrals were previously granted and any financial reports outstanding from the period prior to the external administrator's appointment.
C1Q2 Do you agree that a deferral should be for up to 12 months?	C1Q2 No, consideration should be given to allowing applications for deferrals for a period of up to 24 months, with the deferral period ending on a specified event, for example that the company returns to the control of directors or enters liquidation. A shorter period can be applied for if the external administrator doesn't consider that 24 months is necessary. The external administrator should provide reasoning in the application to support the period applied for. If an external administrator is of the view that 24 months may be required, there is little benefit to the administration to require further applications to be made at additional cost every 12 months, if appropriate support for the period of the deferral can be provided with the original application. The regulatory guide at 174.73 says that "Other than in exceptional circumstances, an individual deferral will be for 12 months". This

	wording should be removed and alternate wording allowing for applications up to 24 months inserted.
C1Q3 Do you agree that we should be able to grant consecutive deferrals of up to three months at a time where a controller has been appointed?	C1Q3 No, we think 3 months is too short and the period should be 6 months.
C1Q4 Do you agree that we should consider granting relief from some or all of any previously deferred financial reporting obligations, where the deferral has been ongoing for a long period of time? In your experience, what sort of circumstances should we take into account when considering whether to grant this relief?	C1Q4 Yes; this should be automatic if the company proceeds into liquidation or is deregistered; but it should also be granted if the external administrator can demonstrate that the members have no economic interest in the company at the time of cessation of the external administrator's appointment. This will resolve the issue of the directors or creditors not having taken action to wind an insolvent company up prior to the finalisation of a receivership. The Regulatory Guide should provide guidance on the criteria for the members having no economic interest.
C1Q5 Do you think that there are situations where we should grant relief from specific obligations, rather than all of the financial reporting obligations, where an externally administered company is required to prepare and lodge a financial report? In your experience, what sort of circumstances should we take into account when considering whether to grant this relief?	C1Q5 Yes, we make the following suggestions: • The external administrator may wish to prepare financial statements (ie. for sale purposes), but may be unable to comply with some of the obligations (eg. director's report and declaration). • Relief from sending the annual report to members, alternatively relief could be given to make the report available online or by email to members.

ASIC's Proposal

C2

We propose to include, in our updated RG 174, guidance on when we will provide an individual deferral of the financial reporting obligations of registered schemes, where:

a) the value of the net assets of the scheme, determined in accordance with Australian accounting standards, is unknown but is likely to be no more than $5,000 throughout the relevant financial year; and

b) ASIC has been formally notified of the commencement of the winding-up of the scheme.

We propose that, other than in exceptional circumstances, an individual deferral will last no longer than 12 months.

ASIC's Questions	***ARITA's Comments***
C2Q1 Do you agree with our proposal? Please describe and quantify the benefits and costs of our proposal.	C2Q1 This is unclear as the criteria for exception under the proposed class order include similar criteria. As such, it is likely that a registered scheme would meet the criteria under both the class order and applications for individual relief. The criteria should be mutually exclusive. If there is uncertainty about the solvency of the scheme and that is why individual relief is being sought rather than relying on the class order, then the proposed criteria needs to reflect this. It is our view that where there is uncertainty as to the solvency of the scheme it is unlikely that a determination that "net assets ... is unknown but likely to be no more than $5,000 throughout the relevant financial year" would be able to be made. Furthermore, as discussed at B2Q1 above, the asset determination criteria has many difficulties associated with it. We also suggest that RG174 be amended to allow for an exemption to be granted on the finalisation of the winding up of the scheme where deferrals have previously been granted.
C2Q2 Are there any situations that are not covered by our proposed guidance? If so, please give details.	C2Q2 It may be relevant where a receiver is appointed by the Court to the Scheme.
C2Q3 Do you agree with our proposal that relief will be provided for up to 12 months?	C2Q3 For the same reasons given at C1Q1 and C1Q2, the period should be for up to 24 months. The proposed wording in RG174 at paragraph 174.99 in respect of "rare and exceptional circumstances" is also likely to create severe limitations for ASIC to grant further relief even though relief may be practical and otherwise warranted. We also suggest that RG174 be amended to allow for an exemption to be granted on the finalisation of the winding up of the scheme where deferrals have previously been granted.

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C3

We propose to include, in our updated RG 174, guidance on when we will provide an individual deferral of the financial reporting obligations in Ch 2M for a registered scheme that has an externally administered responsible entity. Our proposed updates will clarify that:

a) we will not grant relief from the financial reporting obligations of a registered scheme merely because its responsible entity is being externally administered; and

b) we may grant an individual deferral of some or all of the financial reporting obligations of a registered scheme where the appointment of an external administrator to the responsible entity has created circumstances where compliance with the obligations would impose an unreasonable burden.</td></tr>
<tr><td>ASIC's Questions

C3Q1

Do you agree with our proposal? Please describe and quantify the benefits and costs of our proposal.</td><td>ARITA's Comments

C3Q1

The period of an application for deferral should be up to 24 months (refer C1Q1 and C1Q2).

We consider that the use of the words "in exceptional circumstances" in paragraph 174.108 will create inappropriate limitations in granting further relief. The experience of our members is that the external administration of the responsible entity will generally take longer than 12 months. The administration of Schemes and their responsible entities is usually complex and involved, with a range of circumstances that may mean that Schemes will not be wound up, but there is no entity capable of preparing the financial reports - the regulatory guide should recognise this.

In relation to paragraph 174.105 where the scheme must comply with any deferred reporting obligations before the relief expires, we consider that this is too onerous and does not provide discretion to ASIC. There is a wide variety of circumstances in these administrations and ASIC should have discretion to deal with them.

We also suggest that RG174 be amended to allow for an exemption to be granted on the finalisation of the external administration of the responsible entity where deferrals have</td></tr>
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C3Q2 Are there any situations that are not covered by our proposed guidance? If so, please give details.	previously been granted. C3Q2 No
ASIC's Proposal C4 Where we have granted an individual deferral of the financial reporting obligations in Ch 2M of a registered scheme, we propose that we will generally not grant relief from the requirement in s601HG for a responsible entity to obtain a compliance plan audit report.	
ASIC's Questions	***ARITA's Comments***
C4Q1 Do you agree with our proposal? Please describe and quantify the benefits and costs of our proposal. C4Q2 Are there any situations that are not covered by our proposal? If so, please give details.	C4Q1 Again, there is an issue around the criteria regarding the net value of assets being below $5,000 throughout the relevant financial year. This may be very difficult to determine and we refer you to our previous responses on this issue. A better criteria may be a determination as to the likely insolvency of the scheme. Essentially it seems that if the scheme has obtained class order exemption or individual relief, and the responsible entity is in liquidation and does not hold as AFS licence, ASIC will consider granting an individual exemption from the obligation to obtain a compliance plan audit report. The guidance should just say this instead of setting a set value requirement. C4Q2 There should be discretion granted to ASIC as there will be circumstances where the responsible entity is in liquidation but the scheme is not yet being wound up; but, a compliance plan audit would be irrelevant and very expensive to obtain.

ASIC's Proposal	
C5 We propose to update our guidance on individual AGM relief for externally administered public companies.	
ASIC's Questions	***ARITA's Comments***
C5Q1 Do you agree with our proposed guidance on individual AGM relief for externally administered public companies?	C5Q1 It is our view that wherever relief or deferral of financial reporting is granted, the same exemption or deferral should apply in relation to AGMs (where the company is required to hold one). This would apply for all types of external administrations.

Other comments on draft RG174

- Section A Overview – In the key points in Section A, B and C, there is the use of the term "if/provided our policy objectives are met". In the experience of our members, this has been interpreted as an initial hurdle and at times, so strictly applied that it is unlikely relief should be granted under any circumstances. Guidance needs to be provided to ASIC employees as to the relationship between ASIC's policy objectives and Draft RG 174.

- Paragraph 174.10 lists the types of external administrations, including voluntary winding up. Clarification is required that this include a members' voluntary winding up.

- In paragraph RG174.49 there is a reference to advertising in a national or relevant daily newspaper. This should be a reference to advertising on the Insolvency Notices website operated by ASIC.

- Paragraph RG 174.127 states that the application for relief should be lodged in sufficient time for ASIC to consider the application before any statutory timeframe for which relief is required has expired. However, what happens in circumstances where the appointment only occurs in the days leading up to the due date? Once an application is lodged there should be a moratorium on compliance with the financial reporting requirements until the application for relief is determined and to allow sufficient time to prepare the reports should the application for relief be unsuccessful.

- Table 5 does not refer to Managing Controllers appointed to the whole or substantially the whole of the company's assets, yet a company subject to this type of administration can apply for relief (refer Table 3). We note however that there is discussion at paras RG 174.139 to RG 174.141. The table should include a line item.

- We disagree with the conclusion at 174.141 that a controller that has management power and is appointed to the whole or substantially the whole of the company's property, has to, along with the directors, either cause the company to comply with their financial reporting obligations or apply to ASIC for relief from those obligations. This is discussed in detail

earlier in this submission.

- Paragraphs 174.142 to 174.143 advise that either the directors, a voluntary administrator, a liquidators or a provisional liquidator of a responsible entity may apply for relief for a registered scheme. However, it does not outline who may apply if only a controller is appointed to the responsible entity of a registered scheme and the directors have either resigned or refuse to co-operate with the controller.

- Paragraphs 174.144 to 174.145 advise that relief may be applied for under section 111AT of the Corporations Act. This may be relevant to the above queries where there are no directors or the directors will not co-operate with a controller. However, section 111AT refers to ASIC granting an exemption from all of specified disclosing entity provisions. Clarification is required that ASIC is only permitted to grant an exemption to the financial reporting obligation or AGM requirements, and not merely a deferral, when an application is made under section 111AT. Clarification is also required that an external administrator may apply for relief when the directors fail to perform their duties.

- Paragraphs 174.150 to 174.153 advise that an application can be made for a no-action letter. We presume that these paragraphs are meant to cover the situation of a managing controller. However, as we do not consider that the obligation to provide the financial reports lies with a managing controller, a managing controller is not in a position to request a no-action letter. A no-action letter also provides little comfort to a managing controller. Greater clarity is required on the obligations of a managing controller in relation to financial reports.

Should you wish to discuss any aspect of this submission further, please do not hesitate to contact our Technical Director, Ms Kim Arnold on or by email at .

Yours sincerely

John Winter
Chief Executive Officer