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

Dear Mr Wright

Consultation Paper 223 - Relief for externally administered companies and registered schemes being wound up - RG 174 update

This submission is made in response to Consultation Paper 223 released by the Australian Securities and Investments Commission ('ASIC') on 25 August 2014.

Introduction

KordaMentha has made several submissions to the government and relevant authorities regarding the external administration and insolvency regime in Australia and the associated obligations. Our observations expressed in this submission reflect our extensive experience in working on complex and large restructurings and insolvencies in the Australian market. We note that many of our external administrations have had financial reporting obligations and so have a range of experiences to draw upon.

Reporting entity concept

Prior to responding to the specific questions of Consultation Paper 223, we would like ASIC to consider the appropriateness of the obligations of externally administered companies to provide financial reports. This issue has been deeply considered by KordaMentha over the last few years, prompted by ASIC's enquiries as to whether the financial reporting obligations of various companies in external administration have been met. We have a number of issues that we would appreciate if ASIC would consider them and reassess whether the obligation really exists for companies in external administration to provide financial reports. This may require further reform in the area of corporate law or amendments to Draft Class Order.

Reporting entity concept

We consider that the ASIC's *Draft Regulatory Guide 174: Relief for externally administered companies and registered schemes being wound up ('Draft RG 174')* is based on the 'legal entity concept' of financial reporting, whereby the obligation arises based on the type of company. However, we consider that this concept has been superseded by the reporting entity concept of preparing financial statements and reports, which looks at the end users' needs. We refer to the *Statement of Accounting Concepts SAC 1 'Definition of the Reporting Entity' ('SAC 1')*.

At paragraph 7 of SAC 1, it states that:

> Statement of Accounting Concepts SAC 2 'Objective of General Purpose Financial Reporting' states that general purpose financial reports are prepared to provide users with information about the reporting entity which is useful for making and evaluating decisions about the allocation of scarce resources. … In addition, if the regulation of general purpose financial reporting is to be developed on a rational and efficient basis, it is equally important that those entities for which there is no justification to report are not required to report. (emphasis added)

In paragraph 10, SAC 1 explains the legal entity concept of financial reporting:

> These concepts include the legal entity concept, which has been employed in legislation in the private sector, and a broad concept based on accountability of elected representatives and appointed officials, which has been employed in the public sector. In the private sector it has been common for entities to be required to report whenever they have had legal status (for example, companies have been so obliged).

We consider the legal entity concept is the basis on which the Draft RG 174 has been developed, whilst not necessary considering SAC 1. Paragraph 12 outlines the reporting entity concept, which we consider has not been adopted in the development of the Draft RG 174:

> This Statement adopts a concept of the reporting entity which is tied to the information needs of users and the nature of general purpose financial reports. The concept requires that individual reporting entities be identified by reference to the existence of users who are dependent on general purpose financial reports for information for making and evaluating resource allocation decisions. This means that a class of entity defined under another concept, such as the legal or fund concepts (for example, proprietary companies or special and general purpose funds), may include some entities which should be identified as reporting entities, by virtue of the existence of users dependent on general purpose financial reports prepared by the entity, and other entities which should not be so identified. (emphasis added)

Accordingly, we would argue that the users associated with externally administered companies and registered funds being wound up have no need for general purpose financial reports, rather their requirements are specific to the context of external administrations, such as:

- Estimated realisation of assets
- Estimated statutory recoveries
- Estimated returns to creditors, and
- Receipts and payments in relation to the period of the external administration.

All this information can be provided via alternative sources and accordingly, the requirement to provide financial reports in the context of external administrations is irrelevant.

Paragraph 13 of SAC 1 continues with which entities should prepare financial reports and which ones should not:

> It should therefore be noted that the concept of the reporting entity adopted by this Statement is not dependent on the sector - public or private - within which the entity operates, the purpose for which the entity was created - business or non-business/profit or not-for-profit - or the manner in which the entity is constituted - legal or other. It is a concept which is tied to the objective of general purpose financial reporting and, as noted in paragraph 12, is a concept which requires all entities with users dependent on general purpose financial reports for information to prepare such reports. (emphasis added)

Paragraph 36 of SAC 1 sums it up by stating:

> The entities which need not prepare general purpose financial reports are those in respect of which it is reasonable to expect that users dependent upon information contained in general purpose financial reports for making and evaluating resource allocation decisions do not exist.

Accordingly, it is important to consider the discussion in relation to users and alternative sources of information in the judgement of Logan J in *Owen, in the matter of RiverCity Motorway Pty Limited (Administrators Appointed) (Receivers and Managers Appointed v Madden (No 3)* [2012] FCA 313 ('Owen'). At paragraphs 18 and 22 of the judgement in Owen, the issue of end user is raised, along with the issue of the usefulness of general purpose financial reports for externally administered entities, whereby the nature of external administrations, the members no longer have an economic interest in the entity. In externally administered entities, only the creditors have an economic interest and their needs for information about the decisions they need to make are catered for by the 'special purpose financial reports' that external administrators (such as voluntary administrators, managing controllers, liquidators etc.) provide to them and can provide to them on request from the creditors. These reports are not balance sheets and profit and loss statements such as found in general purpose financial reports, but specific reports on the estimated returns to classes of creditors. The creditors have no need for balance sheets and profit and loss statements, and neither do the members, as they, in the vast majority of situations, no longer have an economic interest in the entity. As an external administrator has a number of statutory reporting obligations, the relevant financial information required by these users would generally be readily available.

In the rare circumstance in which it would be justified to spend the funds to prepare accounts under Part 2M.3 of the Corporations Act, for an externally administered entity, is where it is estimated that the members will have an economic interest in the entity at the conclusion of the external administration. Such a situation may exist where a Deed of Company Arrangement allows the company to be resuscitated, which provides the members with an economic interest in the entity after the external administration is concluded. It may also exist where there is no concurrent appointment with a receiver or receiver and manager and it is expected that the members will have an economic interest in the entity after the receivership is concluded. However, external administrators are suitably skilled to identify those rare situations and ensure that the general purpose financial reports are prepared (though in the case of a receiver with no concurrent appointment, we will argue later in this submission that this obligation would lie with the directors of the entity).

On this basis, we submit that ASIC should incorporate the reporting entity concept, which has been used in Australia for many years, in determining whether general purpose financial reports should be generally required for externally administered entities, instead of the legal entity concept.

Further, to remove any uncertainty as to whether externally administered entities are required to prepare financial reports, we suggest that Part 2M.3 be amended to specifically exclude externally administered companies unless it is determined the members will have an economic interest in the entity after the external administration is concluded.

General purpose financial reports

General purpose financial reports are generally prepared on the going concern concept. This concept is not applicable to externally administered entities (except for when it is determined that it is likely that the members will continue to have an economic interest in the entity). *AASB 101 Presentation of Financial Statements* ('AASB 101') sets out in paragraphs 25 and 26 the concept of going concern and from when the concept should be departed. Also of relevance are paragraphs 23 and 24, where AASB 101 sets out that "compliance with a requirement in an Australian Accounting Standard would be so misleading, that it would conflict with an objective set out in the Framework, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance" by making certain disclosures.

We suggest that the majority of the requirements of AASB 101 would be so misleading to the users of any financial reports, which would generally be limited to the creditors of the externally administered entity that the financial reports would be of no relevance to those users. Further, we contend that the other financial reports required to be prepared by externally administrators are of much greater relevance and usefulness to the users and a wiser allocation of scarce resources. Such financial reports include:

- Form 507: Report as to Affairs – section 421A of the Corporations Act requires a managing controller to submit this report within 2 months after the control day
- Form 524: Presentation of Accounts and Statements – sections 411(9)(a), 432(1A), 438E, 445J and 539(1) require external administrators to submit this report within 6 months after the day of appointment, for each subsequent period of 6 months throughout the external administration and for the period from the last report to ceasing as the external administrator
- Receipts and payments to creditors at various stages, such as requests for the approval of remuneration
- Statements or reports about a company's business, property, affairs and financial circumstances – sections 438B(2) and 439A(4)(a)

Again, we suggest that Part 2M.3 of the Act be amended to specifically exclude externally administered companies, unless it is determined the members will have an economic interest in the entity after the external administration is concluded, on the basis that financial reports prepared on a going concern concept that:

- General purpose financial statements are of no relevance or use to the users, the majority being the creditors of the company
- The users have alternative sources of information, which are of greater relevance to them
- Externally administered entities have extremely scarce, if any, resources, and should be allocated reasonably, particularly as it is generally the creditors who ultimately bear the costs of the preparation of any financial reports.

Class Order 03/392 Externally administered companies: financial reporting relief

Class Order 03/392 Externally administered companies: financial reporting relief ('CO 03/392') provides an exemption for companies in liquidation from financial reporting obligations. As an alternative to amending the application of Part 2M.3 of the Act to externally administered entities, we consider the draft class order could be revisited to determine if it would be appropriate to widen the application to:

- All reporting entities
- All types of external administrations
- Only when it has been determined that the members no longer have an economic interest in the entity

This would allow externally administered entities to retain the obligation to prepare financial reports when it is determined that members will continue to have an economic interest in the entity at the conclusion of the external administration, whilst granting an exemption to all other external administrations. The benefits of this would be:

- Greater certainty to external administrators that they will not be required to prepare financial reports
- Eliminate allocation of resources to requesting relief, including the application fee and the remuneration incurred by the external administrators in preparing the application
- Eliminate allocation of resources to preparing financial reports if an application for relief is unsuccessful

Alternative sources of financial information

Currently, external administrators are required to prepare a number of alternative sources of financial information, as outlined above, which we consider is of greater use to the relevant users. We suggest that access to these sources could be greatly increased by the following methods:

- Access to reports lodged with ASIC should be available to creditors for no fee
- Obligations created for external administrators to provide access to certain reports on their websites (if they have one)

Obligations of certain external administrators to prepare financial reports

We have argued above that the obligations for all external administrators to prepare financial reports should be removed. However, if the above arguments are not accepted, we contend that in relation to receiverships, including a controller and a managing controller (collectively known as 'controller'), there is no power for a controller to request specific relief from the financial reporting obligations, despite it being suggested in *Regulatory Guide 174: Externally administered companies: Financial reporting and AGMs* ('the Current RG 174') that such a power exists.

As outlined in our letter to ASIC dated 30 May 2012 in response to ASIC's letter of 26 April 2012, we consider that it is not the responsibility of a controller to attend to the financial reporting obligations of a company in receivership, rather it is the responsibility of the voluntary administrator or the deed administrator (if one is appointed) or the responsibility of the directors if there is no other concurrent external administration. This is supported by the circumstances of a receivership in which KordaMentha is involved, where the directors of the company made the application for specific relief on the appointment of the Receivers and Managers.

Notwithstanding that the Current RG 174 appears to place such an obligation on controllers appointed over the whole or substantially the whole of a company's property, Draft RG 174 suggests at paragraph 174.141 that the controllers and the directors (if any) need to act together to cause the company or scheme to either comply with the financial reporting obligations or to apply to ASIC for relief from those obligations. If there are no directors or the directors are unwilling to act with the controller, there is no guidance as to how a controller would cause this to occur.

Further, Part 2M.3 of the Act requires the inclusion of a directors' report. As a controller is not a director of a company in receivership, this is not a requirement that a controller is in a position to meet.

On 31 December 2007, subsection 421(2) of the Act was introduced to provide directors, as well as creditors or members of a corporation, the right to inspect the records kept by a managing controller of property of the corporation for the purposes of recording and explaining all transactions that the managing controller enters into. This gives the directors the required access to the financial information they require to meet their financial reporting obligations.

Further, we consider that sections 250PAA and 250PAB of the Act, which relate to exemptions ASIC may grant from the obligation to hold an annual general meeting, support that it is not the responsibility of a controller to meet the obligations in relation to financial reports. Section 250PAA specifically refers only to companies that are being wound up, subject to a deed of company arrangement or in voluntary administration and section 250PAB only refers to applications being able to be made by a liquidator, an administrator or an administrator of a deed of company arrangement. These sections specifically do not refer to companies in receivership, nor do they contemplate a controller making such an application. As the obligations for holding annual general meetings lie with directors, much in the same way that the obligations for providing financial reports lie with directors, these sections support that both of these obligations do not lie with a controller

Further, at KordaMentha, we have had the experience where a director of a company in receivership is exercising his residual powers in his capacity as a director to another related company to commence litigation, indicating that not only does that director recognise that he has residual powers but that he is actively exercising them.

Accordingly, we contend that it is not the responsibility of a controller to deal with the obligation of preparing financial reports.

Response to Consultation Paper 223

We understand that our above commentary on the reporting entity concept requires an alternative approach and so we provide our response to Consultation Paper 223 on the assumption that there will not be any wholesale changes to Draft RG 174.

Question A1Q1

KordaMentha supports Option 4 as outlined above where the reporting entity concept is adopted instead of the legal entity concept and a more realistic approach as to the needs of the users is considered.

However, in the likelihood that Option 2 is adopted, KordaMentha supports the general concepts of Option 2 as it provides greater clarity on the circumstances in which relief will be granted. Specific concerns are outlined in response to ASIC's questions. However, our overriding concern is that we consider the period of 12 months to be insufficient. We consider that the period of two years that ASIC currently generally grants for either an exemption or relief is more appropriate. Our reasoning is that the external administrator generally invests considerable time either preparing the request for relief or assisting the directors with their preparation and then liaising with ASIC in relation to further queries. To do this every twelve months would be onerous and the costs in relation to this would ultimately be borne by the creditors. Further, in our experience, the grounds for relief generally do not significantly change during this period. However, to address this risk, ASIC could grant conditional relief on the condition that grounds for relief continue to exist and if they fail to exist, then the relief will cease unless a subsequent application is made outlining alternative grounds within an appropriate timeframe, such as one month.

In support of this, we have examined 673 completed external administrations, which include all the types of external administrations listed by ASIC in the Key Terms of Draft RG 174. The average duration of these administrations was 584 days and only 24% were less than 12 months. Of those greater than 12 months, the average duration was 767 days. Based on this sample, if the period of relief was extended to two years, then 54% would be finalised within this period and only one application for relief would need to be submitted for those administrations.

Another area of concern is the risk that financial reports will need to be completed when the relief expires. In the vast majority of external administrations, creditors do not receive a dividend of 100% and so there is no ongoing economic benefit for members. However, with the possibility of having to provide financial reports, funds would need to be set aside for the contingent costs in relation to the preparation of financial reports. Further, additional costs would be incurred during the external administration to ensure all the information is available to prepare financial reports in accordance with Australian accounting standards, as external administrations generally account for their transactions on a cash basis.

Following this, we fail to see that there is a substantial distinction between liquidations and receiverships to warrant the different treatment. We consider that if a receiver and manager determines that the members no longer have an economic benefit in the company, then the company should be exempted from providing financial reports, not merely be granted a deferral. We suggest that ASIC's comment in Consultation Paper 223 at paragraph 59 that there have been instances where the external administrators' declarations as to the members' ongoing economic benefit in the company have been misconceived or have changed are rare. We would suggest that the declarations provided by external administrators are correct in the majority of situations so the risk that financial reports which should have been prepared have been exempted would occur in a minute number of external administrations. To reduce these rare instances, ASIC could provide criteria or guidelines for determining whether there is an economic benefit.

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In summary, amendments we would like to see to Draft RG 174 are:

- Extend exemption from financial reporting to external administrations where the external administrator has determined to that there is no ongoing economic benefit for members. Accordingly, this would include a number of receiverships.
- Extend deferral period from 12 months to two years
- Include greater certainty that an exemption can be granted by ASIC at the end of a deferral.

Question A1Q2

If option 2 is adopted, we consider that there will be an increase in the burdens to the external administrators by only providing a deferral period of 12 months, mainly by increasing costs of the external administrators as they will have to lodge applications for deferral more frequently than currently required and by increasing expenditure in preparation for potentially having to provide financial reports at the end of the deferral period.

Burdens

- Remuneration of external administration team in preparing financial reports and liaising with ASIC in relation to queries re applications for relief.
- Availability of employees of external administration to assist in preparation of financial reports – often employees have been retrenched or have resigned to take employment with a company with a future. In one recent engagement, the financial controller remained in his position until ASIC granted an exemption from financial reporting as he would have been required to assist with the preparation of the financial reports. Otherwise, he was not required. This increased the costs of the engagement purely to meet any financial reporting requirements.
- Availability of information:
  - If financial reports have not been lodged for prior years, this will increase the cost of preparing financial reports to either prepare those prior years or to estimate an opening position.
  - If the company's books and records are stored electronically and are held to ransom by a third-party host, the external administrator will generally have to pay all amounts owing to the third-party host to access the books and records
- Increase in auditor's fees – in our experience, the auditor's fee will increase due to the perceived increase risk in relation to conducting the audit and potentially because the lack of future audit fees.
- Difficulty in liaising with uncooperative directors
- Uncertainty when there are no directors appointed to the company

Benefits

- During the sale of business, if financial reports are available, it may increase the amount the business is sold for, particularly if the external administrator has traded the business and improved its performance
- Access to grants that require the provision of financial reports
- Compliance with project requirements
- Lodgement of tax returns

All these benefits can be achieved by the external administrator electing to comply with the financial reporting obligations because the benefits outweigh any burdens. External administrators are suitably skilled to assess these benefits. In our experience, we have been able to comply with these requirements by providing specific purpose reports, rather than general purpose financial reports.

In our experience, users of financial reports would not find the information provided in financial reports useful as it would generally not be relevant to prepare the financial reports on a going concern basis. Alternative sources of information would be of greater relevance to users, being:

- Form 507: Report as to Affairs – section 421A of the Corporations Act requires a managing controller to submit this report within 2 months after the control day
- Form 524: Presentation of Accounts and Statements – sections 411(9)(a), 432(1A), 438E, 445J and 539(1) require external administrators to submit this report within 6 months after the day of appointment, for each subsequent period of 6 months throughout the external administration and for the period from the last report to ceasing as the external administrator
- Receipts and payments to creditors at various stages, such as requests for the approval of remuneration
- Statements or reports about a company's business, property, affairs and financial circumstances – sections 438B(2) and 439A(4)(a)
- Other reports to creditors

Further, we would argue that the users have no need for general purpose financial reports, rather their requirements are specific to the context of external administrations, such as:

- Estimated realisation of assets
- Estimated statutory recoveries
- Estimated returns to creditors and
- Receipts and payments in relation to the period of the external administration.

All this information is provided via the alternative sources listed above and accordingly, the requirement to provide financial reports in the context of external administrations is largely irrelevant.

Question A2Q1

In relation to managing controllers, if the directors of the company do not make an application for the deferral of the financial reporting obligations, greater guidance is required on what a managing controller should do and the consequences for the managing controller if the financial reporting obligations are not satisfied.

Question B1Q1

We generally support the proposed new class order. Specific concerns and comments are detailed below.

Question B2Q1

We have concerns with the requirement that 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.

Our concerns relate to:

- The relevance of determining the value of the net assets throughout the relevant financial year – the circumstances of a registered scheme could change significantly throughout a financial year and it is not relevant if there were net assets of more than $5,000 at a particular point in time throughout the financial year if the registered scheme is now insolvent.
- The difficulty in determining the value of net assets throughout the relevant financial year – the registered scheme may not have sufficient books and records to determine the value of net assets throughout the relevant financial year. It also would not be possible to determine the value of net assets at all times throughout the relevant financial year and so it would be

necessary to select particular points in time throughout the financial year, such as quarterly or monthly.

- The requirement for the value of net assets to be determined in accordance with Australian accounting standards – in most circumstances, any financial information available is unlikely to be determined in accordance with Australian accounting standards. This is usually only available at year end and potentially at half year. More common would be for management accounts to be available. The requirement for the value of net assets to be determined in accordance with Australian accounting standards is too high a standard.

Accordingly, the requirement that a registered scheme being wound up has net assets of the scheme where the value, determined in accordance with Australian accounting standards, is no more than $5,000 throughout the relevant financial year is not relevant and is difficult to determine. Further, the other requirements should be sufficient bases to provide a class order exemption.

We note that the wording in Draft RG 174 differs to that in Consultation Paper 223. Instead of 'net assets to be determined in accordance with Australian accounting standards' as detailed in Consultation Paper 223, Draft RG 174 refers to 'the value of net assets of the scheme is no more than $5,000 throughout the relevant financial year'. We suggest that determining the value of net assets based on Australian accounting standards is far more onerous than the wording in Draft RG 174. However, the requirement to determine the value of net assets throughout the relevant financial year is onerous under both scenarios.

We note that in Draft RG 174 in Table 3 at paragraph RG 173.23, the wording for determining the value of net assets includes the words 'in the reasonable opinion of the responsible entity'. We propose that it would be appropriate to include similar wording in Table 2 at paragraph RG 174.21, such as 'in the reasonable opinion of the liquidator'.

We have further concerns with the requirement in paragraph 174.92 that a resolution is passed by the responsible entity to the effect that the scheme property is insufficient to meet the debts of the responsible entity in that capacity as and when they become due and payable. If a managing controller has been appointed to the responsible entity, it is not uncommon for the directors of the responsible entity to fail to co-operate with the managing controller. Alternatively, the directors may have resigned from the responsible directors. If either of these situations arise, then this condition will not be able to be met as a resolution will not be able to be passed.

Further, in relation to paragraph 174.92, there is the option where a person other than the responsible entity is appointed by the court to wind up the scheme, they should ensure that they have properly documented their determination that the scheme is insolvent, and the basis for their determination, before relying on the class order exemption. We suggest that this should not be limited to 'a person other than the responsible entity appointed *by the court* to wind up the scheme' (emphasis added), rather it should be 'a person other than the responsible entity appointed to wind up the scheme'. This will allow a person winding up the scheme to determine that the scheme is insolvent if the responsible entity is not able to. This will also provide some flexibility where the responsible entity has not passed a resolution that the registered scheme is insolvent.

Paragraph 174.93 should also have this limitation removed.

We note that there is not a similar provision for registered schemes as there is for companies at paragraph RG 174.36 in relation to outstanding financial reporting obligations. We consider that it would be appropriate to include this for insolvent registered schemes.

Question B2Q2

We support the granting of relief to registered schemes that are being wound up as outlined at B2 except for the requirement that a registered scheme being wound up has net assets of the scheme where the value, determined in accordance with Australian accounting standards, is no more than $5,000 throughout the relevant financial year for the reasons outlined at our response to Question B2Q1. We recommend that this requirement be removed. We also recommend the wording of 'by the court' be removed in paragraph 174.92 and paragraph 174.93 as outlined at Question B2Q1.

However, at KordaMentha, there have been engagements where the scheme has not been wound up, but a receiver and manager has been appointed by the court. Presuming these schemes were insolvent, it may be appropriate to include this situation to be covered by the proposed guidance.

Question B2Q3

There may be a variety of reasons why a scheme is being wound up, including where the scheme's purpose has been accomplished or a specified event has occurred. Often the winding up will be conducted by the responsible entity. However, there may be circumstances where there the responsible entity does not conduct the winding up of the scheme and it is necessary for a liquidator to be appointed to wind up the scheme. In these circumstances where a liquidator is appointed to wind up the scheme and the scheme is solvent, it may be appropriate for relief to be granted in these circumstances. Further, a scheme may be solvent but may not be meeting its compliance obligations. In those situations, it may be appropriate for class order relief to be granted. Accordingly, some discretion should be added to RG 174 for those circumstances.

Question B2Q4

If the scheme is insolvent or a liquidator has been appointed to wind up the scheme, then we agree with the proposal that ASIC 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. We do not consider it necessary that the liquidator be one that has been appointed by a court to wind up the scheme. Further, if greater discretion was granted as outlined in Question B2Q3, then this should extend to ASIC taking a no-action position in relation to the final audit.

However, if the scheme is being wound in the ordinary course, then the provisions in the constitution of the scheme to arrange for a final audit to be undertaken should be complied with.

Other comments

Form 5138 does not provide for the inclusion of the details of a liquidator if one is appointed to wind up the scheme. Form 5138 must be signed by a director or a secretary of the responsible entity. If a liquidator has been appointed to wind up the scheme, then this may not be possible to occur. Accordingly, form 5138 should be amended so that a liquidator may also sign form 5138.

Question B3Q1

Yes

Question B3Q2

Yes, because it is unlikely that the liquidator would be in a position to arrange for outstanding financial and AFS licensee reports.

Question B4Q1

Yes, because Draft RG 174 should reflect ASIC's powers.

Question B5Q1

Yes, because there should be consistency within Draft RG 174 to the various external administrations if there is similar reasoning, such as the unreasonable burden to comply within a shorter period than six months.

Question B6Q1

Yes, because if ASIC no longer requires this notice, then an external administrator is undertaking an unnecessary task.

Question B7Q1

We agree that ASIC should remove the requirement of the newspaper advertising condition for alternative distribution of financial reports.

We support the recommendation that notice be given on a website maintained by the external administrator and would support more opportunities to make information, notices and reports generally in an external administration available on a website maintained by external administrators.

However, there may be a small number of circumstances where an external administrator does not maintain a website. In those circumstances, an alternate method may be required, such as notice be given on ASIC's published notices website for a nominal fee.

Question C1Q1

Our preference would be the continuation of granting an exemption as the deferral proposed creates too much uncertainty as to whether financial reports will need to be provided in the future and so additional costs will need to be incurred if the requirement to provide financial reports does eventuate.

We are also concerned that the period of 12 months is too short when a managing controller has been appointed or the company is subject to a deed of company arrangement and does not reflect the length of external administrations. In most circumstances, a period of 12 months will be sufficient for a voluntary administration.

We are also concerned that ASIC has an unrealistic view on the outcome of managing controllerships. It would be extremely rare that the members continue to have an ongoing economic benefit in the company. However, it is not uncommon for a managing controller to be appointed where the members do not have an ongoing economic interest in the company, however the company is not currently being wound up and may not be wound up. In those situations, ASIC should be able to provide an exemption from reporting obligations, not merely a deferral. To address the concerns of ASIC listed in Consultation Paper 223, ASIC could grant a conditional exemption that the exemption ceases as if it had never been put in place if the external administrators determine at a later date that members will have an economic interest or if a company returns to the control of the directors on the effectuation or termination of a deed of company arrangement. The reporting obligations would then be resurrected as if the exemption was never granted.

Further, ASIC could assist in reducing the incidence of external administrators incorrectly declaring that it is uncertain whether members have an ongoing economic interest in the company by providing guidance on factors relevant to making the decision about the members' ongoing economic benefit. We have experienced ASIC not being in a position to grant relief because ASIC was not satisfied with the assessment of the members' ongoing economic interest. However in other situations, ASIC was satisfied with the assessment of the members' ongoing economic interest based on similar assessments. Accordingly, this would provide greater consistency in ASIC's response to applications based on similar information.

Another issue is the deferral being limited to 12 months. There are a number of classes of assets that take longer than 12 months to dispose of in an orderly manner, such as rural properties, large commercial properties etc. There may also be issues to deal with prior to disposal, such as litigation or completion of construction to maximise the value of the assets that will increase the timeframe of disposal in an orderly manner.

There is too much uncertainty as to the need to provide financial reports on the expiry of the deferral. We suggest that Draft RG 174 be amended to also allow ASIC to provide an exemption on the finalisation of an external administration where deferrals have been granted by ASIC during the course of the administration and the circumstances on which the deferrals were based continue to apply. This would address the issue where there has not been an application by a creditor to

wind up the company and the directors have not taken any action to place the company into liquidation.

Question C1Q2

We would recommend the initial deferral be two years. In our experience, the majority of companies that have financial reporting obligations have large or complex assets and it takes longer than 12 months for them to be disposed of in an orderly manner. Examples include:

South Eastern Secured Investments Limited	Collection of loan book
Ansett Australia Limited	Sale of spare parts and insurance run off period
Redbank Project Pty Limited	Power station

We are concerned with paragraph RG 174.73 in Draft RG 174, where it says:

"Other than in exceptional circumstances, an individual deferral will be for 12 months."

We do not consider that these are exceptional circumstances and that wording should not form part of the language in Draft RG 174.

Question C1Q3

We consider that there are few situations where a controller would be appointed over a company that has financial reporting obligations and they are not a managing controller.

We agree that ASIC should be able to grant consecutive deferral of up to three months at a time where a controller has been appointed.

Question C1Q4

We consider that if the initial bases for providing relief have not changed or if there are other relevant bases, then ASIC should grant relief for all of any previously deferred financial reporting obligations.

This should primarily be the case when the members continue not to have an ongoing economic interest in the company. Further, in our experience, the factors that initially established the unreasonable burden generally do not improve over time – the expected costs of compliance will generally increase when a company is in external administration and these costs will usually be borne by the creditors.

Further, in our experience, we have very few (if any) enquiries from members, particularly after the initial communication on appointment of the external administrator, requesting information. The majority of queries would relate to the members' ability to claim a capital loss on their tax return. Accordingly, if the external administrators have had limited enquiries from members, it would indicate that the members have little interest in the financial reports. Other relevant users generally have other information available, such as reports from the external administrators and the Form 524 lodged with ASIC by the external administrators.

Question C1Q5

We agree that there may be situations where ASIC should grant relief from specific obligations where an externally administered company is required to prepare and lodge a financial report.

In our experience, there are some situations where it is appropriate to prepare and lodge a financial report, such as when it is expected to sell the shares of a company, rather than the assets, or it is necessary to trade the business prior to its sale and financial reports are required to be provided to interested parties. In these situations, some of the obligations may not be able to be complied with, particularly those obligations that are provided by the directors, such as the provision of a directors' declaration or the provision of a directors' report, if the directors are not co-operative or resigned

prior to the appointment of the external administrators. In those situations, we have generally provided specific purpose financial reports.

It may be appropriate to request relief from the obligation to send the annual report to members when there are a high number of members, particularly if there have been a relatively low number of queries from members. Alternatives to sending the report to all members may be to send or email it to members on request or have the report available on a website (if appropriate). This is particularly relevant when the cost to mail the report to members will be borne by creditors and the members do not have an ongoing economic interest in the company. In our experience, the courts have granted orders that mail outs to creditors can be replaced by a one page letter notifying creditors that the information can be found on a particular website when the cost has been extremely expensive. A recent example is the voluntary administration of Bluestone Global Limited (In Liquidation). An application was made to the Supreme Court of Victoria prior to the second meeting of creditors requesting an order under section 447A of the Corporations Act to adjust the regime for giving notice of the second meeting and providing the section 439A report to creditors such that:

- Notice of the second meeting is emailed and posted to creditors and published in The Australian newspaper
- The notices inform creditors that the section 439A report to creditors can be accessed by creditors from the Administrators' and their lawyers' websites or be telephoning a dedicated hotline and requesting a copy of the section 439A report to creditors

The Administrators had estimated that the cost to mail out the section 439A report to creditors to 4,300 creditors would be approximately $35,000 to $45,000 (ex GST) whereas the adjusted regime would cost approximately $6,500 (ex GST), thus saving costs of approximately $30,000 to $40,000. This application was granted by the Supreme Court of Victoria.

We note that at paragraph RG 174.51, ASIC allows alternative distribution methods for financial reports for an externally administered company with more than 100 members. We consider that due to the burden of costs, it would be appropriate to allow an alternative distribution method if there are more than 50 members.

Question C2Q1

We have concerns with the requirement that 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.

Our concerns relate to:

- The relevance of determining the value of the net assets throughout the relevant financial year – the circumstances of a registered scheme could change significantly throughout a financial year and it is not relevant if there were net assets of more than $5,000 at a particular point in time throughout the financial year if the registered scheme currently does not have net assets of more than $5,000.
- The difficulty in determining the value of net assets throughout the relevant financial year – the registered scheme may not have sufficient books and records to determine the value of net assets throughout the relevant financial year. It also would not be possible to determine the value of net assets at all times throughout the relevant financial year and so it would be necessary to select particular points in time throughout the financial year, such as quarterly or monthly.
- The requirement for the value of net assets to be determined in accordance with Australian accounting standards – in most circumstances, any financial information available is unlikely to be determined in accordance with Australian accounting standards. This is usually only available at year end and potentially at half year. More common would be for management accounts to be available. The requirement for the value of net assets to be determined in accordance with Australian accounting standards is too high a standard.

Accordingly, the requirement that a registered scheme being wound up has net assets of the scheme where the value, determined in accordance with Australian accounting standards, is no more than $5,000 throughout the relevant financial year is not relevant and is difficult to determine. Further, the other requirements should be sufficient bases to provide a class order exemption.

We note that the wording in Draft RG 174 differs to that in Consultation Paper 223. Instead of 'net assets to be determined in accordance with Australian accounting standards' as detailed in Consultation Paper 223, Draft RG 174 refers to 'the value of net assets of the scheme is no more than $5,000 throughout the relevant financial year'. We suggest that determining the value of net assets based on Australian accounting standards is far more onerous than the wording in Draft RG 174. However, the requirement to determine the value of net assets throughout the relevant financial year is onerous under both scenarios. Further the wording is inconsistent between Table 3 at paragraph RG 174.23 and paragraph RG 174.96.

Again we suggest that Draft RG 174 be amended to also allow ASIC to provide an exemption on the finalisation of the winding up of a registered scheme (whether or not the responsible entity is under external administration) where deferrals have been granted by ASIC during the course of the administration and the circumstances on which the deferrals were based continue to apply.

Question C2Q2

At KordaMentha, there have been engagements where the scheme has not been wound up, but a receiver and manager has been appointed by the court. If these schemes were not insolvent, it would appropriate to include this situation to be covered by the proposed guidance.

Question C2Q3

We consider that a period of 12 months is not sufficient for granting relief – see our response to Questions C1Q1 and C1Q2 for our reasoning.

Further, we consider the wording 'in rare and exceptional circumstances' in paragraph RG 174.99 is likely to create severe limitations for ASIC in granting further relief. Accordingly, if the initial bases for providing relief have not changed or if there are other relevant bases, then ASIC should grant further relief for the next 12 months and all of any previously deferred financial reporting obligations. Our experience indicates that the winding up of a registered scheme will generally take longer than 12 months. The schemes mentioned above both commenced in 2006 and will shortly be finalised. To apply for relief every 12 months would increase the costs considerable.

Again we suggest that Draft RG 174 be amended to also allow ASIC to provide an exemption on the finalisation of the winding up of a registered scheme (whether or not the responsible entity is under external administration) where deferrals have been granted by ASIC during the course of the administration and the circumstances on which the deferrals were based continue to apply.

Question C3Q1

We consider that a period of 12 months is not sufficient for granting relief – see our response to Questions C1Q1 and C1Q2 for our reasoning. An example is Timbercorp Securities Limited (In Liquidation) ('TSL') where the voluntary administration commenced on 23 April 2009 and the liquidation commenced on 29 June 2009. The schemes have not been wound up. Under Draft RG 174, ASIC would only be able to provide relief for the first 12 months.

We consider the wording 'in exceptional circumstances' in paragraph RG 174.108 is likely to create severe limitations for ASIC in granting further relief. Our experience indicates that the winding up of a registered scheme will generally take longer than 12 months. For example, TSL is the responsible entity for schemes which were still on foot at the time of appointment. As Liquidators, we approached the growers with a proposal to wind up the schemes which was not accepted by the growers. Accordingly, the schemes have continued in existence but have not been compliant. Action in relation to the schemes has been taken with the approval of the Court, based on applications made to the Court by the liquidators. It is not feasible for the schemes to be wound up based on present circumstances.

In relation to paragraph RG 174.105 where it states that a registered scheme that has been granted a deferral must comply with any deferred financial reporting obligations before the relief expires, we consider that this is too onerous and it does not provide any discretion for ASIC. Our experience indicates that there is a wide variance in circumstances and this would be too strict for all those circumstances.

Again we suggest that Draft RG 174 be amended to also allow ASIC to provide an exemption on the finalisation of the external administration of the responsible entity where deferrals have been granted by ASIC during the course of the administration and the circumstances on which the deferrals were based continue to apply.

Question C3Q2

No

Question C4Q1

We consider that there may be some difficulties in obtaining a compliance plan audit report. There may be some reluctance from an auditor, regardless of whether they are the current auditor, to provide this. The cost of obtaining a compliance plan audit report would be considerable and is likely to be borne by the creditors of the registered scheme. Further, a number of the components of a compliance plan audit report would not be able to be provided as they are no longer relevant.

Again the wording differs between Table 3 in paragraph RF 174.21 and paragraph RG 174.111 in Draft RG 174 in terms of determining the value of net assets. We suggest that the wording in Table 3 in paragraph RF 174.21 is the most appropriate. However, our concerns with having to determine the value throughout the year is a concern.

Question C4Q2

We consider that there are registered schemes where the responsible entity is in external administration but the registered scheme is not yet being wound up, such as TSL. However, a compliance plan audit report would not be relevant. We consider that ASIC should be given discretion as to whether a compliance plan audit report is required.

Question C5Q1

We agree with the proposed guidance on individual AGM relief for externally administered public companies.

However we suggest that if our suggestion that Draft RG 174 be amended to also allow ASIC to provide an exemption on the finalisation of an external administration where deferrals have been granted by ASIC during the course of the administration and the circumstances on which the deferrals were based continue to apply is adopted, that an ability for ASIC to provide an exemption in relation to AGMs as well to ensure consistency between relief available for financial reporting and AGMs. This would address the issue where there has not been an application by a creditor to wind up the company and the directors have not taken any action to place the company into liquidation. This would only be necessary when a managing controller has been appointed as paragraphs RG 174.121 to RG 174.123 would apply to companies under voluntary administration and companies subject to deeds of company arrangement.

Comments on Draft Regulatory Guide 174

Section A – Overview

In the key points in section A (as well as sections B and C), there is the use of the term ‘if/provided our policy objectives are met’. In our experience, this has been interpreted by ASIC employees as an initial hurdle and at times, so strictly that it is unlikely relief would 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 includes a members' voluntary winding-up.

Section B – Financial reporting relief for externally administered companies

Paragraph RG 174.78 advises that ASIC may grant an exemption from some or all of the previously deferred financial reporting obligations. Is it likely that this would apply to a long-running external administration where ultimately there is no economic benefit to members?

Section C – Financial reporting relief for registered schemes

The note to paragraph RG 174.91 advises that the class order exemption does not apply where the conditions have been met for only part of a financial year. The measurement of the value of net assets must be done at a point in time – it cannot be done over a period of time. The requirement to determine the value of net assets throughout the relevant financial year is unable to be achieved. ASIC has not provided its rationale as to why the value of net assets has to be determined throughout the relevant financial year and why the exemption or deferral does not apply if this condition is not met.

We note that it would not be uncommon for a registered scheme to have net assets with a value greater than $5,000 earlier in the financial year however be insolvent at the date of winding up. Further if the registered scheme had net assets with a value greater than $5,000 earlier in the financial year but is now insolvent, then the registered scheme is unlikely to have funds available to comply with its financial reporting obligations and this cost will be borne by its creditors.

Section E – Applying for relief

Paragraphs RG 174.139 to RG 174.141 advise that when a controller is appointed, the application for relief must be made by the directors and if the controller has control over management of all the day-to-day operations of the company or the scheme, the controller and the directors need to act together to cause the company or scheme to either comply with the financial reporting obligations or to apply to ASIC for relief from those obligations.

Clarification is required as to the responsibilities of the controller when the directors have resigned from the Company (whether processed by ASIC or not) or when the directors will not co-operate with the controller.

For example, Mark Korda and Bryan Webster are appointed as Receivers and Managers to RCL Group Limited. On appointment, all the directors resigned from the company, which was accepted and processed by ASIC two days after the appointment of the Receivers and Managers. In this situation, how would the Receivers and Managers cause the company to either comply with the financial reporting obligations or to apply to ASIC for relief from those obligations? If the Receivers and Managers were not able to cause either option, what would be the consequences for the Receivers and Managers or the company?

Paragraphs RG 174.142 to RG 174.143 advise that either the directors, a voluntary administrator, a liquidator 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 the directors will not co-operate with the controller. Clarification is required for this situation.

Paragraphs RG 174.144 to RG 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 of the Corporations Act refers to ASIC granting an exemption from all or specified disclosing entity provisions. Clarification is required that ASIC is only permitted to grant an exemption to the financial reporting obligations or AGM requirements, and not merely a deferral, when an application is made under section 111AT of the Corporations Act. Clarification is also required that an external administrator may apply for relief when the directors fail to perform their duties.

KordaMentha

In relation to paragraph RG 174.146, clarification is required that an external administrator may apply for relief under 992B when the directors fail to perform their duties.

Paragraphs RG 174.150 to RG 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. It also provides little comfort to a managing controller. Greater clarity is required on the obligations of a managing controller in relation to financial reports.

Inconsistency

We have noted that the wording in Draft RG 174 in relation to the value of net assets of registered schemes is not consistent throughout Draft RG 174. See

- RG 174.21 Table 2
- RG 174.23 Table 3*
- Section C Key points
- RG 174.90 (b)
- RG 174.91
- RG 174.96
- RG 174.111

Yours sincerely

Mark Korda
Partner