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KordaMentha

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

Dear Sir

Consultation Paper 337
Externally administered companies: Extending financial reporting and AGM relief

KordaMentha welcomes this extension of financial reporting and AGM relief for externally administered companies. We provide comments to assist ASIC in its consultation process. We note that KordaMentha is also supportive of the submission provided by ARITA.

If you would like to discuss any comments further, please contact Trudi Shepard of our office by email at tshepard@kordamentha.com.

Yours sincerely

Leanne Chesser
Partner

	ASIC's question	KordaMentha's comments
B1Q1	Do you agree that we should conditionally extend the current deferral relief to a period of up to 24 months? (a) If not, why not? (b) If so, do you consider that the deferral period ought to be available for up to a maximum period of 24 months and why?	Yes. 24 months should be adequate time to determine the future of the company and for it to be clearly demonstrable whether the members of the entity have any economic interest in the company if a further application for relief or exemption is made. This would have been beneficial on a recent administration where a new board had been appointed to a not-for-profit company and had to approve financial reports shortly after their appointment to the board due to the cessation of relief on the transition from voluntary administration to deed of company arrangement.
B1Q2	In what circumstances do you consider it is not appropriate to extend the deferral period to up to 24 months for an externally administered company?	No comment
B2Q1	Do you agree that we should include early cessation triggers relating to the end of an external administration? Are there any other situations you consider should bring about an early end to the deferral period?	Early cessation triggers are reasonable. However, ASIC should ensure that it properly assesses the situation, the benefit of financial reporting, the composition of the members and likelihood of members receiving a return in the external administration. We refer to your comment in paragraph 28 of the Consultation Paper that "a company that exits external administration does not continue to have the benefit of financial reporting relief and that the users of the company's financial reports have access to the reports **from the point in time that the company ceases to be under external administration or shortly thereafter**" (emphasis added). It is unrealistic to expect financial reports to be provided from the end of the external administration or shortly thereafter where early cessation triggers occur, which may be with no warning to the company or the external administrators. Accordingly, if the early cessation trigger occurs within the first six months of the deferral period, the external administrator or the directors (depending on the circumstances) should have the period to six months from the date of appointment to provide the financial reports or to apply for individual deferral relief or individual exemption, if either of those were applicable. If the early cessation occurred after the first six months of the deferral period, ASIC should ensure that measures are in place to provide adequate time for financial reports to be prepared, such as three to six months after the early cessation trigger. Further, it should be clear who is responsible for preparing the accounts and bearing the cost. In situations where the company is under the control of the directors, that responsibility and costs should fall on the directors, not the external administrators. In a recent example, on the sale of the companies, the purchaser had to prepare audited financial statements within three months of the sale. This was a large impost on the purchaser, in terms of allocation of resources and due to the size and complexity of the group, when trying to stabilise the group after a lengthy voluntary administration/deed of company arrangement. It would have been beneficial for the purchaser if the period of time to prepare the reports had been longer, such as six months.
B3Q1	Do you agree with our proposal? If not, why not?	Yes

	ASIC's question	KordaMentha's comments
B4Q1	We are seeking feedback on whether to impose the following new conditions	
	(a) Do you agree with our proposal to require companies to put in place arrangements to make any Form 5602 and any Form 5603 publicly available free of charge? If not, why not?	We note the comment in paragraph 34 of the consultation paper that public information (including the Form 5602 and 5603) are available from ASIC, however the information is not available free of charge. ASIC should make this information available free of charge if it wants the information to be available. We note that the data in the Form 5602 and 5603 is lodged with ASIC in a structured data form. At times, particularly on external administrations with a large number of transactions, this information is not able to be easily provided to third parties as the PDF version available upon lodgement with ASIC at times does not include all the data. If external administrators were required to provide the information, we also have concerns with the Forms being made publicly available by the external administrators. If external administrators are forced to do this, we suggest that they should be made available to members. The reason for this is that external administrators routinely make information available to creditors on a website that can only be accessed by a password or a code or through a creditors' portal that requires registration, including a username and password. The same arrangements could be put in place for members. However, this could incur costs in the external administration which would be borne by the company's creditors.
B4Q1	(b) Do you consider that we should require companies to provide management accounts to members? (i) If not, why not? (ii) What type of management accounts would external administrators be comfortable with providing to members, and why? (iii) Please outline any unintended consequences as a result of ASIC imposing this requirement and the appropriate strategies to deal with each of the identified unintended consequences.	Companies should not be routinely required to provide management accounts to members. These are not available to members in normal circumstances, though we appreciate ASIC is exploring options. Preparing management accounts will create an additional burden on the company or, in the majority of cases, the external administrators, to provide information that may be substantially the same as the information available in the Form 5602 and Form 5603, particularly as a vast number of DOCAs do not involve the external administrators trading a company and are limited to realising assets or receiving contributions for the purposes of distribution. The cost of preparing management accounts will be borne by creditors. Further, the reporting cycle is different to that of the Form 5602/Form 5063 so it would be substantially the same information but on a different reporting cycle, providing little value to the creditors or members. Another issue is that external administrations are generally prepared on a cash accounting basis, not an accrual accounting basis, and so preparing the information would be costly, if it were able to be prepared at all. Management accounts would only be of value if the company was operating substantially the same as previously and the external administrators were in charge of the management of the company. In that situation, the company may as well meet the financial reporting obligations, as it is likely that ASIC would require their lodgement at the end of the relief period. However, this would be a distraction to the external administrators who in those circumstances would still be focused on trying to save the company and its business. If the external administrators are not in charge of the company and its business, then they have no access to the management information of the company. Their records are limited to cash in and cash out of a DOCA bank account.

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		An alternative would be for reports to creditors to be also available to members on request, though not publicly available, for the reasons expressed in B4Q1(a). This would provide sufficient information to members about the activities of the externally administered company so that they may be properly informed about the company's affairs. Note that in the majority of situations, creditors have a greater economic interest in the affairs of the company than members. No or minimal additional costs would be incurred. In our experience, ASIC has required additional reporting in situations where there was no value. For example, in one situation, ASIC required additional reporting to members where a court had granted a section 444GA application, so the members clearly no longer had an economic interest in the company.
B4Q2	Do you consider that we should impose any other additional conditions during the deferral period?	Only in extremely limited situations. If any additional conditions are to be applied, then ASIC must examine the specific circumstances of the particular company to ensure unnecessary costs are avoided, remembering the costs are being borne by the company's creditors, not the company or the external administrators.
B5Q1	Do you agree with our proposal to exclude certain entities from relying on our financial reporting deferral relief? If not, why not?	As ASIC has indicated in the consultation paper that ASIC anticipates that it will rarely be exercised, it seems reasonably to include it. However it is difficult to comment on whether the examples or scenarios that ASIC intends to include in RG174 are reasonable because no examples or scenarios have been given. However, in relation to paragraph 37 of the Consultation Paper, we would like to correct your statement that the costs of preparing and lodging financial reports is borne by the administrator. The costs of preparing and lodging financial reports are an expense of the administration and so reduce the amount available to creditors. Accordingly, the benefit of providing fulsome information to the market, who no longer have an economic interest in the entity, is being borne by the creditors, who have already suffered losses.
B5Q2	In what circumstances do you consider that ASIC should exercise the proposed power to exclude certain entities from relying on our financial reporting deferral relief?	No comment
B6Q1	Do you agree that the relief and our guidance is operating effectively? If not, please provide details of any concerns or issues that you have so that we may consider addressing these when updating our policy and guidance.	We do not agree that the relief and ASIC's guidance is operating effectively. We have a number of examples where ASIC's decisions did not make sense. This may be because ASIC does not have sufficient discretion in its decision making. It would also be beneficial if decisions relating to individual relief or individual exemption were reviewable by the AAT. Example 1 • Business was not able to be sold as a going concern and the business was wound down • The directors proposed a contribution DOCA where a pool of funds was made available for distribution to creditors - all employees and the secured creditor were paid in full and unsecured creditors were ultimately paid a dividend of 13.6 cents in the dollar. • The company was a wholly owned subsidiary of another entity, which was privately owned. There was no surplus available to the member. The subsidiary and parent entity shared common directors. The company and ultimate parent company were related entities.

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		• The company was a 'grandfathered' large proprietary company, such that it was required to comply with the financial reporting obligations but did not need to lodge the reports with ASIC • Financial reports as at 30 June 2018 were outstanding when the external administrators were appointed as voluntary administrators. No financial reports were required for subsequent years as the entity no longer met the definition of a large proprietary company. • The directors of the company had confirmed in writing it was their intention to deregister the company as soon as the DOCA had been effectuated and had provided the external administrators with a signed Form 6010 deregistration request with an irrevocable consent stating the deregistration request was to be lodged immediately after the DOCA was effectuated. This was outlined to ASIC in the exemption application and copies of the documents signed by the directors were provided. • As the exemption was not granted, the external administrators did not lodge the Form 6010 on behalf of the directors. • However, the directors did exactly what they said they would do and lodged a deregistration request with ASIC within 2 business days of the DOCA effectuation. • Over $50,000 of creditor funds were expended on preparing 2 year old accounts on a company that by that stage had no assets, no employees and no business – and it was in deregistration mode within a week of the DOCA being effectuated. • The financial reports did not provide any benefit to the sole member who was already fully aware of the financial situation of the company Example 2 • Unlisted public company required to lodge repeated requests for individual deferral, instead of an exemption, when it was a holding company with no assets. Example 3 • A group of companies had historically lodged one set of accounts. However, when making the application for financial reporting relief, ASIC required two separate applications as there were two deeds of cross guarantee in place, causing the external administrations to incur additional unnecessary costs, which were borne by the creditors. Example 4 • When making an application for financial relief, an application needs to be made for each company, even when only one set of accounts incorporates a number of companies. One application involved 22 companies, so at the current fee level of $3,487, that would be an amount of $76,714 for relief from lodging one set of accounts. This is an excessive amount which would be borne by the creditors.
C1Q1	Do you agree with our proposal to extend the period of time by which a public company under relevant administration must hold an AGM until two months after the reporting deferral relief expires? If not, why not?	Yes

	ASIC's question	KordaMentha's comments
C2Q1	Do you agree with the conditions proposed? If not, why not? Should any other conditions be imposed?	Yes
C3Q1	Do you agree with our proposal to include an exclusion power so ASIC can exclude certain entities from relying on the proposed AGM deferral relief? If not, why not?	Yes. As ASIC indicated that ASIC anticipates that it will rarely be exercised, it seems reasonable to include it. Also, the ability to have ASIC's decision reviewed by the AAT is beneficial.
C3Q2	In what circumstances do you consider that ASIC should exercise the proposed exclusion power?	No comment