1 October 2021

Ms Genevieve Sexton – Panel Chair
Safe Harbour Review
Treasury

By email: SafeHarbourReview@treasury.gov.au

Dear Ms Sexton

Review of the insolvent trading safe harbour

Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia, 'the Major Accounting Bodies, represent more than 300,000 professional accountants in over 100 countries, supported by more than 19 offices globally. We make this joint submission to the review of the insolvent trading safe harbour (the provision) on behalf of our members, many of which are directors themselves, and in the broader public interest.

We consider the provision is currently sound in terms of giving support to the directors of fundamentally viable businesses to turn around the business without the risk of personal liability. From the experience of our members, the parties best able to use this provision are financially literate directors of medium to large businesses whose personal financial circumstances are not intractably entwined with the business.

Conversely, directors of small business are often also the owner and provide their personal guarantee to underpin the capital for the business. As such, we consider that the small business restructuring regime, with similar eligibility requirements as the provision, to offer a more appropriate pathway for directors of small businesses to turnaround a viable business.

Accordingly, with the view that the provision is best used by directors of medium to large businesses, we recommend the requirement to obtain advice from an appropriately qualified entity is made mandatory. An obligation to obtain independent advice will give a degree of confidence to all stakeholders that the actions taken to turnaround the business are reasonably likely to lead to a better outcome than immediate administration or liquidation. Further detail has been provided in our responses to the Discussion Paper questions in Appendix A.

Please do not hesitate to contact either Karen McWilliams at CA ANZ on (612) 8078 5451 or at karen.mcwilliams@charteredaccountantsanz.com or Kristen Beadle at CPA Australia on 0413 883 581 or Kristen.beadle@cpaaustralia.com.au should you have any further questions.

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Yours sincerely

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Appendix A

The feedback detailed below is framed under those questions raised in the discussion paper where we consider we can add value.

1. Are the safe harbour provisions working effectively?

- Across our members, which includes the majority of Registered Liquidators, only a minority have been asked to advise on the provision. Our Registered Liquidator members also advised that they are yet to receive the safe harbour defence against an issued claim of insolvent trading.
- While the confidential nature of the provision currently creates a lack of data on the effectiveness of the provision, any proposed measure to gather data must maintain that confidentiality.
- Equally, any proposed measure to gather data should be incorporated into existing statutory reports.
- For example, to gain an understanding of when a director may have relied on the safe harbour provision to affect a successful turnaround, provide an option to capture use in the Company Statement issued by ASIC each year.
- Where a turnaround has not been successful, capture in Registered Liquidator reports such as Form 507 –include a section to capture if a director reasonably believes that he/she can rely on the provision prior to appointing a registered liquidator. Alternatively, in the *Insolvency initial statutory report* an explicit option for the safe harbour provision when indicating if there any known defences.

4. How has the safe harbour impacted on, or interacted with, the underlying prohibition on insolvent trading?

- Drawing on ASIC statistics, it would appear the introduction of the provision in 2017 has had little impact on reports of misconduct relating to insolvent trading.
- Table 2: Summary of findings-Initial external administrators' reports (2016-17 to 2018-19) (ASIC REP 645, page 7) indicates that, of the top 3 alleged possible misconduct, insolvent trading is not only the highest but has been increasing year on year:

Profile of companies	2018–19	2017–18	2016–17
Top 3 alleged possible misconduct	• s588G(1)–(2) Insolvent trading (5,350 or 71% of reports) • s180 Care and diligence—Directors' and officers' duties (4,141 or 55% of reports) • s286 and 344(1) Obligation to keep financial records (3,294 or 44% of reports)	• s588G(1)–(2) Insolvent trading (5,264 or 69% of reports) • s180 Care and diligence—Directors' and officers' duties (4,097 or 54% of reports) • s286 and 344(1) Obligation to keep financial records (3,329 or 44% of reports)	• s588G(1)–(2) Insolvent trading (4,878 or 63% of reports) • s180 Care and diligence—Directors' and officers' duties (3,818 or 49% of reports) • s286 and 344(1) Obligation to keep financial records (3,335 or 43% of reports)

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5. What was your experience with the COVID-19 insolvent trading moratorium, and has that impacted your view or experience of the safe harbour provisions?

- Insolvent trading moratoriums and inactivity by the Australian Taxation Office have contributed to directors delaying action to address any solvency concerns.
- We consider that it will still be some time before safe harbour is used as a defence as many businesses are still being supported by the various state and federal government stimulus measures.
- Our further expectation is that there a significant number of what will be assetless insolvencies with many business owners merely 'walking away'.

7. Are the pre-conditions to accessing safe harbour appropriate?

- With the view that to affect a turnaround, it is critical to know the true current financial position of a business, we consider the pre-conditions that employee entitlements and statutory obligations under taxation laws have been substantially up to date in the preceding 12 months appropriate as the minimum standard.

8. Does the law provide sufficient certainty to enable its effective use?

- We perceive that the flexibility in the provision reduces certainty in how to use the provision with the unintended consequence that directors do not have confidence that a plan would be able to be defended in court.
- As there is significant personal risk for directors in attempting to turnaround a business that is likely to become insolvent, removing some of the flexibility may provide more certainty for directors that their actions under safe harbour can be relied on in court.
- We recommend making the requirement to seek advice from an independent, appropriately qualified entity mandatory to increase confidence that a plan is achievable and therefore defendable.
- The cost of such advice is far outweighed by the rigour brought to a plan by an independent expert who can ensure employee entitlements and creditors interests are properly considered.
- As we consider it is directors of mid to large sized firms that are best placed to utilise the provision, it is reasonable to make incurring the cost of expert advice part of the provision.

9. Is clarification required around the role of advisers, including who qualifies as advisers, and what is required of them?

- We support clarification on who is an appropriately qualified entity and what constitutes appropriate advice.
- Setting qualifications will increase protection for consumers and reduce the possibility of being misdirected by unqualified, untrustworthy advisers.
- In setting qualifications, the provision would need to be cognisant that advice from several experts with differing skill sets may be required and will vary by the size of the company, the complexity of a corporate structure and the financial health of the business when safe harbour is entered.

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- Equally, what is required of advisers will also vary but should be cognisant that it is the director who is responsible for setting the course and remains in control of the business.
- At a minimum, they should be required to advise if they consider the actions proposed by a director are achievable, could lead to a better outcome, will maintain good governance and what records should be stored to satisfy an evidentiary burden if required.
- Accordingly, we recommend qualifications should capture a range of professionals with the minimum requirement that they are a member of a prescribed professional body and subject to existing professional and regulatory oversight.
- We consider the adviser's role be similar to that of a small business restructuring practitioner in that the adviser oversees the plan, however is not liable for any associated risk should the plan not provide a defence to insolvent trading.

10. Is there sufficient awareness of the safe harbour, including among small and medium enterprises?

- From our members experience, directors of small and medium enterprises (SMEs) do not appear to be aware of the safe harbour provisions.
- For those that are aware who, to bring certainty to their process, would seek to engage an appropriately qualified entity to set up, monitor and update a plan, the cost of which would prove prohibitive.
- Further, a key aspect to an effective plan during safe harbour is based on knowing the financial position of a company which requires all records to be accurate and update.
- As ASIC's insolvency statistics indicate, the resources of directors of SMEs are invested in running their business and they do not necessarily have the additional resources to invest in keeping financial records up-to-date or educating themselves on provisions such as safe harbour.
- We refer to Table 2: Summary of findings-Initial external administrators' reports (2016-17 to 2018-19) (ASIC REP 645, pages 6 and 7) which indicates the majority, 76%, of external administrations are SMEs and over 40% of these failed to keep adequate financial records (see question 4).

Profile of companies	2018–19	2017–18	2016–17
Number of employees affected	76% of reports concerned companies with less than 20 employees	78% of reports concerned companies with less than 20 employees	79% of reports concerned companies with less than 20 employees

- Equally, ASIC statistics show that the majority of SMEs do not seek professional advice while solvent, when the provision could be accessed, but long after becoming insolvent.
- We refer to Table 23: Initial external administrators' reports-Period in which company became insolvent (2016-17 to 2018-19) (ASIC REP 645, page 31) which shows that only 5% of companies sought to appoint an administrator within 3 months of becoming insolvent and more than 58% did so after 16 months or more:

Table 23: Initial external administrators' reports—Period in which company became insolvent (1 July 2018 to 30 June 2019)

Period in which company became insolvent	Reports alleging criminal breach		Reports alleging civil breach	
	Number	Percentage	Number	Percentage
At appointment	1	1.8%	44	0.9%
1–3 months before appointment	5	8.8%	188	4.0%
4–9 months before appointment	8	14.0%	756	16.0%
10–15 months before appointment	11	19.3%	983	20.8%
16–24 months before appointment	8	14.0%	872	18.5%
Over 2 years before appointment	24	42.1%	1,876	39.8%
Total	**57**	**100.0%**	**4,719**	**100.0%**

Note: For all reports in this table, the external administrator reported that there was evidence in support of the alleged breach.

- For directors of small and micro businesses that are likely to become insolvent, if eligible, we consider the small business restructuring regime the more appropriate pathway.

13. Are there any improvements or qualifications you would like to see made to the safe harbour provisions and/or the underlying prohibition on insolvent trading?

- We consider more focus should be placed on financial literacy of, and good governance by, directors in preventing trading a business whilst insolvent.
- Such prevention should take the form of ongoing education for directors on their obligations rather than more regulations to clean up insolvent companies.
- The introduction of the Director ID provides the opportunity to require identification of a director, which will be a significant step to prevent the use of vulnerable people as straw directors.
- In addition, educating directors will minimise setting up a corporation on the misunderstanding that it will protect the director from personal liability where they fail to meet all their obligations rather than being the best structure for the business.
- We acknowledge the role professional bodies, such as ourselves, have to play in educating our members on promoting the most appropriate structure for their clients business and call on the government departments and regulators to work collaboratively to ensure directors know, and know how to meet, their obligations.