Liquidator conduct

ASIC UPDATE

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The results of most of our reviews of liquidator conduct are addressed confidentially with the practitioners or firms that are the subject of a review. However, as in this article, when the privacy of practitioners is protected we often make our findings on the standard of liquidators' conduct more widely available.

This article presents our feedback on conduct we have observed on independence, remuneration practices, banking arrangements, investigations and reporting to creditors and to us and other issues. For more information, also see our findings report on our review of s 439A reports at ***www.asic.gov.au/reports***.

Independence

We regularly identify what appears to be a misunderstanding of the legal obligations of liquidators to be independent and avoid conflicts of interest. Here are some of our concerns:

- Practitioners disregard case law in their explanations to us of why they consider they are entitled to retain an appointment despite circumstances that raise doubts as to their independence in fact or appearance. It is important that you consider how a third party, aware of all the relevant facts, may perceive your independence.
- The IPA Code of Professional Conduct stresses adherence to the spirit as well as the letter of the Code. Compliance with industry guidance does not always guarantee that you have complied with your legal obligations to be independent and avoid conflicts of interest in a particular instance.
- Many practitioners do not adequately document their decision-making process when considering the issue of independence. You should be able to explain the process you followed to consider independence issues and reach the conclusion to accept or retain an appointment.
- It appears that some practitioners accept appointments and then rely on disclosure to creditors of the circumstances that give rise to a potential conflict. You cannot cure a breach of independence per se by disclosing the circumstances to the creditors.

We will be testing the new requirements for administrators and liquidators in a creditors' voluntary liquidation to make a declaration of indemnities and relevant relationships (or DIRRI's as they are becoming known). This is an adjunct to your general legal obligation and does not replace your legal obligations to be independent and avoid conflicts of interest.

Independence requires you to examine all of the surrounding facts and circumstances and we understand that there can be no hard and fast rules. In our reviews, we always ask for an explanation from the practitioner before we review the circumstances for ourselves.

We published an article on this topic in a previous edition of the *Australian Insolvency Journal*.[1] Bankruptcy Regulation also published an article on fiduciary duties that dealt with independence for bankruptcy trustees.[2]

Remuneration

There are recurring issues that we have had to address in our reviews:

- Remuneration has been drawn before it has been approved.
- Remuneration is overdrawn.
- Practitioners have asked a committee or creditors to approve fees for pre-appointment work.
- Before asking creditors to approve remuneration, practitioners have only given limited information to creditors about the tasks undertaken and the time period the claim relates to. We expect there will be an improvement in this area because of your new obligations to provide a report containing sufficient information to allow the reasonableness of remuneration claims to be assessed.
- Special proxies have been used to approve remuneration (before the amendment of reg 5.6.33).

1. (2007) 19(3) A Insol J, p4.
2. (2008) 20(1) A Insol J, p26.

We are continuing to review the adequacy of information creditors are given to help them assess the reasonableness of a practitioner's claim for remuneration.

Banking

During our reviews we have identified practices that concern us:

- For some practitioners it is normal practice for money to be banked in their personal/business accounts rather than in the administration's bank account;
- Payments have been made for administration A from funds belonging to administration B;
- Funds could not be clearly traced because of poor record keeping;
- Materially inaccurate receipts and payments forms have been lodged with us.

There is some debate about whether sub-regulation 5.6.06(1) requires a separate bank account to be opened for each administration, and whether a separate bank account is required for voluntary administrations. However, a separate bank account for each administration would overcome some of the problems that we have discovered.

We are of the view that having adequate systems to properly and accurately record, explain and account for monies received into the external administration is a basic practice capacity. We are continuing to review practitioners' banking policies and procedures.

Investigations and reporting to creditors

We are concerned about the lack of investigations documented in many of the files we review. Sometimes after reviewing an entire file, we are left asking ourselves questions such as:

- Whatever happened to that asset disclosed on the RATA?
- Was there any evidence of possible voidable recoveries and was a conclusion drawn about the potential for these recoveries?
- What was the reason the company failed?

This indicates to us that perhaps an adequate investigation has either not been conducted or has not been documented on file.

Further, we are concerned that:

- the outcomes of the investigations are not fully reported to creditors to give them sufficient information about the conduct of the external administration and to enable them to make informed decisions; and
- potential offences are not reported to us on a timely basis.

We will continue to review the adequacy of investigations as part of our review activities.

Deficiencies in either the investigations conducted or the reporting of the results of those investigations to creditors in voluntary administrations was covered in the report of our review of s 439A reports.

Reporting to ASIC

Our reviews have identified many instances of liquidators who have not lodged s 533 reports on many of their current liquidations. We have doubts that these liquidations fall outside of the s 533 requirements and we are following up these liquidators to make sure that these reports are lodged.

There have been instances where the failure by a practitioner to lodge a s 533 report has compromised our ability to successfully take an administrative banning action against a director for their involvement in two or more failed companies. This, in turn, has compromised the effectiveness of the Assetless Administration Fund.

Please file your reports as soon as practicable so that we can take appropriate action on a timely basis. Our Regulatory Guide 16 *External administrators: reporting and lodging* is currently being reviewed and updated.

Other issues

Our reviews have also identified that:

- Dividends have been declared and either not paid at all or not paid on a timely basis. If dividends are declared, then they should subsequently be paid. We will ask questions when dividends are not being paid expeditiously. These funds belong to creditors and, unless there is a clear reason why the money cannot be distributed you should pay creditors their dividend without delay.
- Forms are not lodged with us at all.

Systems and procedures

We are starting to review the systems and procedures of insolvency firms. To guide these reviews we refer to Regulatory Guide 186 *External administration: liquidator registration.*

We have found in many of our reviews of files that either the lack of adequate up-to-date practices and procedures or the failure to apply firm practices and procedures underlies many of the other issues noted in this article.

Where to from here?

We will continue to report the results of our reviews back to you. We are hoping that raising these issues with you directly and through the IPA (including input to industry guidance) will over time lessen the discrepancy we see between the legal requirements and the standard of conduct that we have encountered in our work.

As a compliance unit, our role is to raise standards through discussion, education and influence only utilising our enforcement remedies when matters are serious, recurring, pressing or intractable.

We will do this by:

- investigating complaints made about liquidator conduct;
- undertaking Compliance Reviews of a registered liquidator's external administration files to assess compliance with their legal and professional duties in relation to their conduct on those particular external administrations;
- undertaking Practice Reviews to assess whether the registered liquidator has adequate policies, procedures and practice capacities to provide reasonable assurance that they are able to perform adequately and properly their duties and functions and review how those systems and procedures are applied in practice;
- undertaking Transaction Reviews to assess compliance by a registered liquidator with their legal and equitable duties on a particular aspect of their conduct in a discrete issue or matter on a specific external administration; and
- undertaking Compliance Projects to review industry compliance with specific duties and obligations. Examples of this are the EXAD database clean-up exercise and the s 439A report project conducted in 2007.