ACCOUNTING NETWORK

Newsletter

FTI CONSULTING

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Contents

We are pleased to provide you with the latest edition of our *Accounting Network* newsletter.

In this edition we focus on industry issues and regulatory matters that have been receiving attention in recent times. These include the *Personal Property Securities Act 2009 (Cth)* and the Fair Entitlements Guarantee scheme provided by the Government for employees of insolvent companies. Additionally, we discuss some trends faced by service providers to the commercial construction sector.

We are always keen to hear from you should you have any questions or comments on anything you've read, so please don't hesitate to contact us.

A reminder about the PPSA and avoiding the loss of priority

Parties need to make sure they register any security interests they have in personal property or risk losing out altogether in the event that a customer becomes insolvent.

From 30 January 2012, the *Personal Property Securities Act 2009 (Cth)* ("PPSA") established a new system for the creation, priority and enforcement of what are termed *security interests* in personal property. Generally, this covers all property other than land, fixtures and some specific statutory interests.

There are some fundamental differences between the concepts underpinning the PPSA and the historical way of looking at security and priority — notably, the PPSA takes a substance over form approach to transactions, and the rules for determining priority aren't based on legal title.

As the PPSA deals with priority disputes, things become interesting when a company is placed into administration or liquidation. To maintain priority there is a requirement for your security interest in property to be *perfected.* Perfection is a new, technical concept in the PPSA and it is fundamental for the protection of a secured party's interest in property. Usually, perfection is achieved by registering on the Personal Property Securities Register ("PPSR"), which provides third parties with notice of your security interest. But if you don't follow the requirements under the PPSA you might lose out altogether, as some parties have found out.

There have been two court decisions in an insolvency context where owners had leased their equipment to customers, but ended up losing their right to recover the equipment (i.e. lost their priority to it) because they had not registered their security interest on the PPSR. So, even though they were the original owners, they were not were not 'first in line' to recover the equipment or receive the proceeds of sale.

When the PPSA began, it provided a two-year *transitional period* to maintain the priority of certain security interests that arose under agreements created before commencement. This protection was known as *temporary perfection* and covered common arrangements such as retention of title, hire and consignment arrangements. But that period expired at the end of January 2014. So, you now have to make sure that you register all your security interests on the PPSR.

A statutory review of the operation of the PPSA is currently underway, and an interim report was released in late July. The findings of that report indicate that, generally, there is a low level of awareness and understanding of the PPSA regime by small businesses. Confusion about its operation, complexity and understanding the new terminology used in the PPSA, were frequently raised in submissions to the enquiry.

We suggest you ask your clients about the PPSA in a general sense to check that they are coping with it. As a starting point you may wish to ask:

- Are they aware of how the PPSA applies to their business?
- Do they know how to access and use the register?
- Whether they lease or hire out goods — you don't want them to inadvertently lose out (like the examples above) in the event of a customer's insolvency.

Why look at simplifying your structure?

You can save time, money and lower risk by having a more streamlined legal and operational structure.

In our August newsletter, we provided some guidance and information around how to close a solvent company and some considerations around when to choose the liquidation or deregistration option. These two options fall within an area of work commonly called *corporate simplification*.

In its simplest form, corporate simplification is about the removal of a legal entity from a group structure, usually because it is dormant and no longer needed. More broadly though, corporate simplification is associated with the restructuring of a business, where streamlining the legal structure coincides with process/performance improvement and cost reduction. Overall, the common theme is around reducing complexity — and it's not just something for the big end of town.

So why should you think about corporate simplification? We provide some thoughts on where benefits can be found:

You'll save time and thus money — Fewer entities in a group typically means less time spent on financials, bookkeeping, tax matters, and general company secretarial work. Time saved equates to dollars saved, allowing more time to be spent on other value-added projects. Also, historic tax planning may have involved complicated legal structures and trusts, but perhaps the benefits of maintaining those structures are no longer there.

Tax advantages when extracting wealth — Certain rules apply when a liquidator is appointed to a company, and there can be tax benefits to members by having a liquidator pay dividends and distribute property.

Legal and operating structures don't align — People can lose track of their personal obligations as directors if the legal structure and business structures don't align, and they can make errors about what entity should enter into supply contracts, hold active/passive assets etc. A simple structure is easier to manage from an operational and governance perspective. Also, if you're planning on selling a business, shares in a company or otherwise transferring ownership, having a simpler legal structure that aligns with the business can be attractive to a buyer. It can also reduce transactional fees and complexity.

Remove legacy risk and helping to resolve ongoing claims — Corporate knowledge is lost over time when key employees or business partners leave, and it can be an issue in particular where you have "inherited" a history via acquisitions. When you don't know the full story from the start, there can be a risk of legacy issues or claims and it might be better to dissolve that entity instead. A liquidator follows a statutory process to call for all claims by creditors — present, future or contingent. It may help bring to an end any ongoing disputes and claims, and if a party still feels aggrieved after the liquidator has reviewed their claim, they'd have to apply to the court and put forward their case.

We welcome any questions or enquiries you may have around corporate simplification, members' voluntary liquidations and company deregistration.

Some changes to the Government's Fair Entitlements Guarantee scheme

Proposed changes to the Government's "safety net" for employees and their unpaid entitlements would take effect from January 2015, with long-term employees of insolvent entities potentially impacted.

For many years now the Government has operated a scheme to help meet the unpaid entitlements of employees who lose their job due to their employer's insolvency. The latest iteration is FEG, a legislative scheme established under the *Fair Entitlements Guarantee Act 2012.* It commenced in December 2012.

There are some eligibility requirements for employees who wish to claim, but perhaps the most important aspect to note is that the scheme only applies to companies in liquidation and persons who are bankrupt — so, the scheme won't be available if a company is only in receivership or administration.

The scheme works by the Government advancing money to pay the entitlements owing to eligible employees. The Government is then able to "stand in the shoes" of those employees in the event that assets in the insolvent entity can be realised and paid to creditors.

At present FEG covers the following unpaid entitlements: wages — up to 13 weeks; annual leave; long service leave; payment in lieu of notice — maximum of five weeks; and redundancy pay — maximum of four weeks per full year of service and pro-rata for less than a full year of service.

Some proposed changes are coming for liquidations and bankruptcies that occur on or after 1 January 2015. Notably, the maximum payment for redundancy pay will be 16 weeks, aligning the FEG scheme with the National Employment Standards for redundancy. The changes appear to have arisen because of the current uncapped nature of redundancy payments, and the fact that Government payments to employees is reported to be increasing, yet only around 11% is being recovered from asset realisations from liquidators and bankruptcy trustees.

The most obvious impact of the changes is on longer term employees who have redundancy caps in their contracts that are more favourable than the National Employment Standards.

It's worth highlighting that there are some sections of the *Corporations Act 2001 (Cth)* that are designed to deter company directors from taking advantage of the scheme for their own (or others benefit), knowing that the Government will be there to "pick up the tab" for employees. This includes making company directors liable to pay compensation where the directors have entered into agreements or transactions with the intention of avoiding payments to employees. There are also the general provisions on directors' duties and the duty to prevent insolvent trading that may apply — e.g. difficulties in being able to pay employees their wages or entitlements is considered a warning sign of insolvency.

Professional services to commercial construction

With some uncertainty around the commercial construction sector in certain markets, there are likely to be professional service providers in need of advice from their accountants and other advisors.

We have observed trends among businesses providing professional services to construction firms, such as architects:

- Work levels are inconsistent.
- Competition is driving rates/quotes lower.
- The common practice of "speccing" early stage concept plans and outline drawings (in the expectation of it leading to paid work once the developer is better funded) is not leading to the levels of work anticipated.
- Redundancies have resulted in a loss of intellectual knowledge and the payout of employee entitlements is using up cash.

With architectural practices being essentially cash flow businesses, the primary assets are typically debtors and work-in-progress. Lending to these businesses is almost always guaranteed by external assets – normally personal guarantees from the proprietors and secured over their homes. This may not leave many options for the financially stressed businesses to obtain additional funding, although there are some other areas that can be looked at:

- An internal review of processes and systems — are there some cash savings or efficiencies that can be gained.
- Invoice discounting/factoring to help with cash flow.
- Mergers/consolidation with similar businesses.
- Where there is financed property and equipment, look at possibly refinancing/rescheduling payments.

For financially stressed businesses, lenders and financiers are often willing to look at proposals put to them for deferments and rescheduling payments as an alternative to immediate enforcement of their security — but with the caveat that the borrower has sought appropriate external help in putting a proposal together. Financiers often want the comfort of knowing that the borrower's accountants and other advisors have helped them review all aspects of business performance, and that a strategy has been developed with specific action/implementation plans in place.

While we've used a specific services example above, the approach taken by banks and lenders to looking at financially stressed businesses is largely the same — they want to see that their clients have sought appropriate help. We can assist with reviewing or developing plans with you and your SME clients, and to help with discussions with lenders.

Please do not hesitate to contact the following team members with any queries relating to this newsletter, or any other business advisory services which FTI Consulting may be able to assist with.

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