



Australian Government

Insolvency and Trustee Service Australia

**INSPECTOR-GENERAL
PRACTICE DIRECTION No 3.1**

**What constitutes an expense
recoverable in a debt agreement
by an administrator**

DRAFT

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PLEASE NOTE: This draft Practice Direction is released for comment and consultation at the Registered Debt Agreement Administrators Professional Development Day on 9 September 2010. It is therefore possible that the content of this Practice Direction may change before being finalised and published to [ITSA's Policies and Practices Website](#).

¹ Released in September 2010 for comment and consultation

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Introduction

1. The purpose of this document is to outline the Inspector-General in Bankruptcy's regulatory role in regard to the principles on which a debt agreement administrator (DAA) may recover expenses in the course of administering a debt agreement.

Statutory Provisions

2. The *Bankruptcy Act 1966* (the Act) sets out the legislative framework in relation to a DAA's right to recover expenses in a debt agreement. This framework is informed by the debt agreement statutory documentation and the [Legislative Instrument](#) in clauses 2.7.16 to 2.7.18.

Bankruptcy Act and the Debt Agreement documentation

3. There are two sections in the Act which deal with debt agreement expenses. .
4. Subsection 185C(2) of the Act states in part,
*"A debt agreement proposal must:
(a) identify the debtor's property that is to be dealt with under the agreement; and
(b) specify how the property is to be dealt with;*"
5. Section 185LA of the Act states in part,
*"The duties of an administrator of a debt agreement include:
(a) dealing with the debtor's property in the manner specified in the debt agreement; ..."*
6. The DAA can only deal with the property of the debtor, that is the payments received (in the vast majority of matters), in the manner prescribed by the agreement.
7. If the debt agreement or any subsequent variation to that initial agreement does not contain any provisions in relation to the payment of expenses by the administrator then the administrator would be failing in their duty by making any payment, in relation to expenses, from the funds held. They would be unauthorised payments.

Guidelines

8. Along with the introduction of the [Bankruptcy Legislation Amendment \(Debt Agreements\) Act 2007](#) on 11 April 2007 the Inspector-General approved [Guidelines](#) relating to the registration and cancellation of debt agreement administrators. These came into effect as law following registration as a Legislative Instrument on 12 April 2007. As well as being law for administrators these also contain some guidance for practitioners on what should constitute expenses capable of being recovered from an administration or an estate. The [Guidelines](#) state:

“As a general guide, any right to reimbursement for out of pocket expenses in a particular administration is limited to actual expenses incurred in respect of that debt agreement and the administrator must be able to show:

(a) how it is directly attributable to the debt agreement; and

(b) how the actual expense for a particular matter was calculated.

Costs not able to be identified to a particular administration and which can only be recovered as a general fixed amount charged across all administrations periodically is considered as remuneration. Such costs are unable to be recovered as an out of pocket expense.”

Expenses

Definition and types of expenses

9. Expenses which may be included in a debt agreement are those expenses incurred directly in the administration of that debt agreement.
10. Examples of expenses which may be included in a debt agreement include dishonour fees incurred as a result of a payment default by the debtor, stop cheque fees incurred when dividend cheques need to be reissued, expenses incurred in certification of a debt agreement proposal such as valuation of an asset and searches to verify the eligibility of the debtor.
11. It is important to distinguish between the expenses incurred by the administrator in running his or her business and the expenses incurred in relation to a particular debt agreement.

Incurred by the DAA

12. An expense which is incurred by a third party such as a broker is not an expense of the debt agreement. If an amount is owed in those circumstances at the time a debt agreement is proposed then the third party to whom the amount is owed should be listed as an unsecured creditor in the proposal.
13. To be validly included in the DAP the expense must be incurred by the DAA.

Dishonour charges

14. One of the most common types of expenses incurred in a debt agreement administration are dishonour charges charged by financial institutions. More often than not these expenses have been borne by the DAA as the DAP for a particular debt agreement had not made provision for these expenses to be reimbursed from that administration's funds.
15. To facilitate the recovery of dishonour charges from debt agreement funds, the DAP and Explanatory Statement form was amended to include an automatic provision for the reimbursement of the dishonour fees without the need to make a specific provision for such expenses at the '*Allowable expenses payable to a third party*' line of the DAP. The current version of the DAP, which became effective from 23 December 2009, now includes the phrase:

'Dishonour charges incurred in the administration of the agreement with an authorised deposit-taking institution, such as a bank, will be recovered from the debtor's payments'.

An extract of the DAP appears below at paragraph 24 of this IGPD.

16. The inclusion of this phrase overcomes the difficulty debtors (and DAAs) faced in not being able to estimate dishonour charges at the time of submitting the DAP. It allows DAAs to recover any dishonour fee expenses that have been incurred in relation to a particular debt agreement from that administration's funds provided the DAP relevant to the agreement is in the current form.
17. This amendment does not apply to debt agreements which were based on the previous versions of the DAP form which did not include any provision for such an expense to be reimbursed from the debt agreement funds.
18. Where there have been multiple instances of dishonour fees incurred by an administration, which will have a material² effect on the dividend payable to creditors, it is expected that the administrator will notify creditors of this and the effect on the dividend rate.

What is not an expense

Expenses of running the DA business

19. Expenses of running the administrator's business are not expenses of a particular debt agreement and cannot be included in a debt agreement proposal. Examples of the expenses of running a business include overhead expenditure such as rent, interest, rates, electricity, depreciation and wages.
20. Expenditure which is not traceable to a particular debt agreement is recoverable by the administrator from the administration funds as remuneration. Small amounts of expenditure which are not cost effective to trace to individual administrations should be treated as an overhead cost of running the administrator's business. Overhead expenses of the administrator's business should not be allocated as expenses of particular debt agreements.

Cost of performing the duties of an administrator

21. Expenditure incurred by administrators in performing their duties is recovered in the form of remuneration which has been approved by creditors, i.e. administrators cannot claim the cost of performing their duties as an expense in a debt agreement. For example, the performance of specific functions such as processing dishonoured transactions or dealing with the assignment of debts are duties of administrators and the costs associated with performing those duties cannot be claimed as expenses.

² Using the same guidance for materiality as outlined in paragraphs 25 and 26 of this IGPD.

Payments to a third party for performing the duties of an administrator

22. Payments for performing the duties of an administrator or for the expenses of the business made to third parties including related parties or in a non-arm's length transaction by the administrator are not expenses of a debt agreement.

Creditor approval

23. As the proposal document and any subsequent variation proposal are subject to the approval of creditors, the inclusion of the expense items and expense amounts on those forms bring them to the attention of creditors and are approved by creditors if the proposal proceeds to an agreement or the variation is accepted. Creditor approval is essential if expenses are to be validly recovered by a DAA in a debt agreement.

Debt Agreement Proposal Form (DAP)

24. There is provision on the debt agreement proposal form and the proposal for variation form for the inclusion of items and amounts for expenses. There are a number of free form fields within each form within which details of expenses can be included. The two prominent areas of the DAP in which to include reference to expenses are shown in the DAP extract below.

Paragraph 185C(2)(aa) Bankruptcy Act 1966	 Australian Government Insolvency and Trustee Service Australia	
23/12/09		
Office Use Only		
Date Lodged	Event No.	Admin No.

Debt Agreement Proposal and Explanatory Statement

The terms of this debt agreement proposal include the provisions of section 185C of the Bankruptcy Act. Dishonour charges incurred in the administration of the agreement with an authorised deposit-taking institution, such as a bank, will be recovered from the debtor's payments.

Personal details

Surname			Title
Given Name/s			
Other Surnames Used	Other Given Name/s Used		
Date of Birth	Drivers Licence Number		
Residential Address			Postcode
Postal Address			Postcode

Debtor's debt agreement proposal to creditors

If the proposal involves making periodic payments or lump sums, please detail below.			Total value of payments
Number of payments	Weekly/fortnightly/monthly	Amount of each payment	
			\$
			\$
			\$
			\$
			\$
Total amount offered in the proposal			\$
less Realisations charge payable to Australian Government		%	\$
less Fees for administrator to administer debt agreement		%	\$
less Allowable expenses payable to third party		%	\$
equals TOTAL amount to be distributed proportionately for unsecured debts			\$

Note 1
Dishonour charges on the RDAA Trust bank account are an example of an expense incurred that may be validly recovered from the debtor's payments.

Note 2

If the DAA expects to incur expenses it is a requirement to estimate their total prior to commencement of the debt agreement – and it is to be expressed here both in percentage terms of each payment and total dollar value.

Materiality and changes in the amount of expenses

25. The materiality issue, which is raised in the [Guidelines](#) at paragraph 2.7.16 relates to changes in the amount of the expense previously approved by creditors. If the change in the expense amount is not material then (subject to approval of the initial amount) it does not need further approval before it can be paid by the administrator from the property of the debtor. If the initial expense has not been approved by creditors then any subsequent question regarding materiality is irrelevant.
26. What is material? As a general guide only, it is acceptable to regard an increase of less than 10% of the original expense amount as immaterial. Therefore if the initial approved expense was expected to be \$140 then an increase of less than \$14 would be immaterial and could be paid, in addition to the original expense amount. If there is an increase of greater than \$14 then this is to be regarded as material and before recovering the additional expense creditor approval is to be sought by way of variation.

ITSA Roles

Debt Agreement Service (DAS)

27. DAS will apply compliance checks to ensure that in a sample of cases the expenses detailed on the DAP are specifically attributable to the debt agreement. For example, it is not acceptable for DAAs to state in a free form field on the DAP that,

“A flat fee of \$50 per month will be taken in expenses for the life of the debt agreement.”
28. If DAS believes an adequate process has not been followed, the Official Receiver may either reject the proposal for processing or cancel it during voting. Intelligence on such matters is provided to ITSA Regulation and Enforcement (R&E) and feedback given to the DAA.

Regulation and Enforcement (R&E)

29. Section 12 provides R&E with the power to investigate and where there are issues of concern either during the annual inspection program or through a complaint being made, R&E will examine the level and validity of expenses claimed by reference to these stated principles and the Legislative Instrument in clauses 2.7.16 to 2.7.18.
30. Where breaches of the law, including the Legislative Instrument, or lack of record keeping are identified a DAA will be asked to take appropriate remedial action including a change in practice. This may also lead to counselling or in serious or systemic cases to either litigation or disciplinary action being initiated including conditions being placed on a DAA's registration.
31. During annual inspections, R&E will examine the systems and controls a DAA has in place in respect to how expenses are recovered. This will include examining documented practices and check lists, delegations and, where a DAA is relying on others to assist, how the DAA properly supervises and train their employees, agents or brokers to properly perform the necessary duties and obligations on their behalf.

Conclusion

32. This Practice Direction outlines the principles informing the Inspector-General's approach to regulating how and when DAAs may legitimately recover expenses in a debt agreement. It will be against these principles and the standards contained in the Legislative Instrument that a DAA's right to expenses will be assessed by R&E.
33. When there are other specific issues where clarification is required, following consultation with DAS, the Inspector-General will continue to develop policy and practice statements to assist practitioners.

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