



Insolvency: Identifying and managing risk

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Insolvency risk – customers, suppliers, directors

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Types of insolvency appointments

- Receivership
- Administration
- Receivership

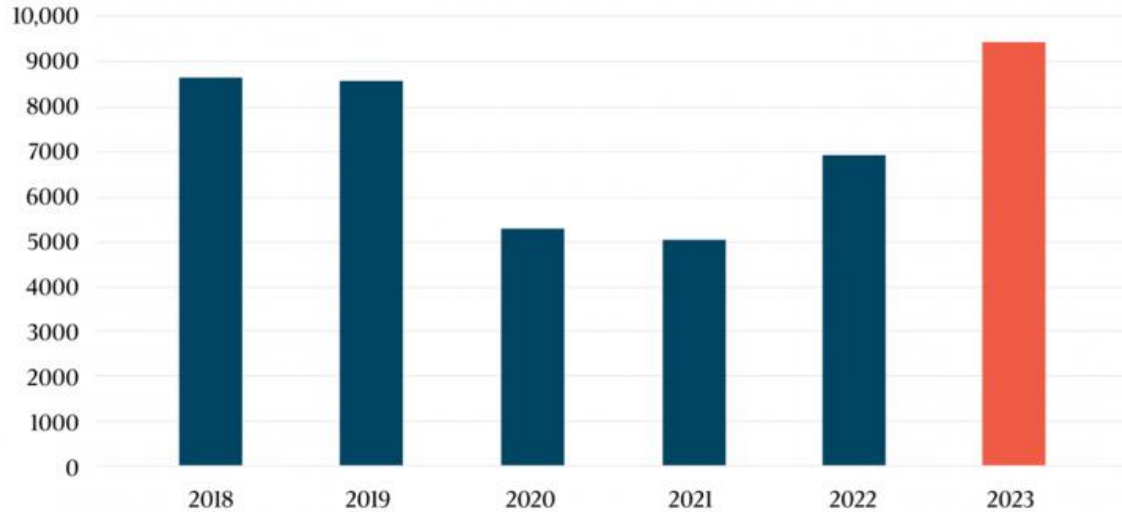
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Managing insolvency risk:

- Suppliers/Supply Chain
- clients/customers
- Directors

Background

Insolvencies by year



Source: Alares

Key Concept



Bankruptcy and Liquidation are the legal consequence of insolvency



What is insolvency?



A person is solvent if, and only if, they can pay all their debts as and when those debts are due and payable

A person who is not solvent is insolvent

Test of Insolvency



Insolvency is a question of fact to be ascertained from a consideration of the company's financial position taken as a whole



Primarily a cash flow test but balance sheet test also relevant



Company can be asset rich but cash poor and still solvent



Insolvency is not a temporary lack of liquidity

Identifying Insolvency

- Liquidity ration below 1
- Ongoing losses
- Poor cash flow
- Poor financial records/ lack of plan or budget
- Increasing debt
- Net asset deficiency
- Unrecoverable loans
- Bad bank or no finance available
- Tax/super unpaid
- Paying creditors outside normal terms
- Letters of demand, statements of claim, judgments
- COD
- Dishonoured cheques
- Preferring certain creditors
- Paying rounded sums
- Internal disputes

Types of insolvency appointments

Receivership

- Appointment by a secured creditor pursuant to a Charge
- Receiver realises assets and repays secured creditor
- Main duty is to secured creditor, not Company
- Receiver often follows VA appointment

Voluntary Administrator

- Appointment by Directors when maybe insolvent
- Considers future of the Company
- Outcome A: Return company to Directors
- Outcome B: Deed of Co. Arrangement
- Outcome C: Liquidation

Liquidation

- Appointment by Directors (or by Court) when company is insolvent
- Finalises affairs of the Company and distributes assets amongst creditors

Insolvency indicators/Red Flags



Customer

- Late payment of invoices
- Negotiating extensions of time to pay
- Paying lump sums (not referable to an invoice)
- Renegotiating terms
- Communication change/change in key personnel
- ASIC search shows changes, including judgments
- Unusually high turnover of staff




Supplier

- Performance of contracts delayed/late delivery
- Asking for additional funds to perform same work
- Renegotiating terms
- Seeking changes to contract terms
- Change in key personnel
- ASIC search shows changes, including judgments
- Unusually high turnover of staff
- Deteriorating service levels or quality standards


Managing insolvency risk in customers/suppliers

Prevention/Preliminary


Preliminary protective measures:




comprehensive initial checks on customers and suppliers, particularly when extending credit (evaluate creditworthiness)



ensuring contract terms (particularly with respect to payment) are robust and fit for purpose



taking security, including registering any security interest on the PPSR (see Episode 6 of our series)









Seek external guarantee/indemnity (and check the means of those offering Guarantee)

Managing insolvency risk in customers/suppliers

Management/Monitoring

Ongoing management:

- 
 maintaining complete records, utilising accounting software that monitors payments; regular monitoring
- 
 invoicing regularly so that delinquency in payment is more easily identifiable
- 
 Act quickly on delinquency. Have a clear recovery plan starting with first call in days immediately after payment missed and escalating from there.
- 
 continued monitoring of payment performance and active engagement with customers throughout the relationship
- 
 regular checks on the financial health of customers (for example, by way of ASIC and PPSR searches) and, if necessary, direct request for company financial information
- 
 COD

Managing insolvency risk in customers/suppliers

Recovery/Enforcement



Calling on security



Calling on personal
Guarantees/indemnities



Exercising rights outside
insolvency (proceedings)



Statutory Demand



Claiming in insolvent
administration (proof of
debt)



Funding investigations



Risk of preference
claims?



Risks for Directors

- ATO Director Penalty Notices
- Personal guarantees
- Director / shareholder loan accounts
- Insolvent trading

Director Penalty Notices

- Directors liable for company's PAYG Tax, GST or SGC.
- **Lockdown DPN** - Fail to pay and lodge Activity Statements or SGC Statements within required timeframes.
- **21 Day DPN** - Fail to pay but lodge Activity Statements or SGC Statements within required timeframes.
- **21 Day DPN** - Option of Small Business Restructuring, Liquidation or Administration within 21 days of date of notice to avoid liability.

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Director Penalty Notices

Time Periods to Avoid Lockdown DPNs

- To avoid **Lockdown DPNs** Activity Statements must be lodged within **three months** of being due
- Timeframe for avoiding **Lockdown DPNs** for SGC has been reduced to:

Quarter	Period	Super due for Payment	SGC Statement Due Date
1	1 July - 30 September	28 October	28 November
2	1 October - 31 December	28 January	28 February
3	1 January - 31 March	28 April	28 May
4	1 April - 30 June	28 July	28 August

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Other Risks

- Personal guarantees.
 - Bank debt
 - Equipment finance
 - Premises leases
 - Trade creditors

Note: Charging clauses

- Director loan accounts
- Insolvent trading

How to Manage Risks

- Make tax lodgements on time.
- Options other than guarantees, e.g. bonds, other trading arrangements etc and manage debts where guarantees given.
- Manage how funds are distributed to directors / shareholders.
- Proactively seek advice when required.
- Consider structures of businesses and who holds other assets.

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Example

Small Business Restructuring

- Real estate agent
- \$600k tax debt
- Assets - commissions and rent roll (financed)
- Director had \$220k of DPNs which had expired
- SBR proposal – pay \$150k (accepted) but also then had to pay the balance of DPNs



Example

Voluntary Administration

- Business running seminars and events
- Due to Covid, business was decimated
- \$800k tax debt, \$150k to landlord (no PG), other debts
- Appointed Administrators over Christmas period, “traded” on business, put forward proposal to creditors of \$100k

Thank you

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