

**INSOLVENCY - CHECKING THE HEALTH OF YOUR BUSINESS**

Companies are focusing on defensive strategies to protect their businesses in light of the economic downturn and diminishing credit availability.

ASIC has also announced its major focus this year will be on Directors to ensure that they have taken the appropriate steps where their companies have become insolvent.

Consequently, Directors are calling in insolvency experts to examine the health of their books and in some cases, calling in administrators earlier than may be necessary.

Understanding the warning signs of insolvency and obtaining the assistance of an experienced insolvency practitioner to assess and restructure at the appropriate time has never been more important. This can make the difference between allowing your business to continue to trade and minimising a Director's potential personal exposure.

**Director Duties**

A company is considered insolvent if it is unable to pay its debts when they become due and payable.

It is not enough to defer this duty to the company accountant or at the time a Director signs off on the yearly financial statements.

It is a positive duty on Directors to consider whether there are reasonable grounds to suspect that the company is insolvent or will become insolvent as a result of incurring a new debt.

**Consequences of Insolvent Trading**

While the Corporations Act 2001 (Cth) provides statutory defences for Directors, these may not be available if Directors have not taken steps to keep themselves apprised of the companies financial position and perform their general director duties to prevent insolvent trading.

Failure to do so can lead to both civil and criminal penalties including fines of up to \$220,000 or imprisonment for up to 5 years or both. Civil and criminal proceedings can also be commenced by ASIC, or by a creditor or a liquidator on behalf of creditors which can lead to the personal bankruptcy of Directors.

**Indicators of Financial Difficulty and Risk of Insolvency**

Some of the key indicators of a company being at risk of insolvency are as follows:

- Recurring losses;
- Weak cash flow;
- Overdue taxes, superannuation and workers compensation insurance; difficult relationship with the bank and inability to borrow;
- No alternative finance and inability to raise further capital;
- Suppliers placing the company on cash on delivery (COD) terms;
- Creditors paid outside trading terms;
- Issuing post dated cheques or dishonouring cheques;
- Letters of Demand from creditors and/or solicitors, judgements or warrants issued against the company.

These indicators are not exhaustive nor do they all need to be present for a company to be insolvent.

If in doubt, an insolvency practitioner can conduct an assessment and recommend options including refinancing, restructuring or appointing an external administrator.

**Summary**

In order to ensure that your company remains financially sound and to minimise director exposure to the risk of insolvent trading, it is recommended that the above indicators are monitored regularly.

Lawyers can advise you on any breach of director duties and if your business is dealing with a company who appears to have the indicators of experiencing financial difficulties. This is also integral to assessing and maximising the prospects of recovering debts and increasing cash flow and reducing your overall business risk.

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