

OPTIONS FOR CLIENTS IN FINANCIAL DISTRESS

Updated 13 November 2020

Introduction

The outbreak of COVID-19 is having an overwhelming impact on individuals, businesses and communities. The purpose of this Fact Sheet is to provide an overview of the options available for your clients in financial distress to help you and your clients navigate through this health and economic crisis.

This Fact Sheet should be read in conjunction with our other CPA Australia issues Fact Sheets '[The meaning of insolvency](#)' and '[Director Duties, Insolvent Trading and You](#)'.

What is insolvency?

In its simplest form, it is an entity's inability to meet its debts as and when they fall due. Insolvency is generally tested on a 'cash flow' test or on the 'balance sheet' test (see previously issued Fact Sheet: [The meaning of insolvency](#) for a more detailed consideration of this topic).

Indicators of insolvency are identified as follows, but are not limited to:

- Continued trading losses.
- Payments to creditors outside trading terms.
- Inability to obtain additional sources of funding, including but not limited to financiers or shareholder funding.
- Inability to meet taxation obligations.
- Non-payment of employee entitlements, such as superannuation.

During the current COVID-19 pandemic, CPA Australia members may see an increase in indicators of insolvency from their clients and/or their clients' associated entities.

The Coronavirus Economic Support Package

The Federal Government has released the Coronavirus Economic Support Package (the Package) to businesses to enable them to navigate through the current financial distress that the COVID-19 pandemic has given rise to. Whilst the Package deals with numerous benefits available for business to access cash flow, tax relief and/or payments to retain workers, it has also implemented insolvency changes to provide temporary relief to directors and businesses on the collection of debts that may fall due during the period of the pandemic as well as insolvent trading.

In relation to the collection of debts, the temporary relief has amended the Corporations Act 2001 (the Corporations Act) and Bankruptcy Act 1966 for a period from 25 March 2020 to 31 December 2020. To summarise:

- For company wind ups - the Statutory Demand threshold has increased from \$2,000 to \$20,000.
- To respond to a Statutory Demand the timeframe has increased from 21 days to 6 months.
- To bankrupt an individual, the threshold amount has increased from \$5,000 to \$20,000.
- To respond to a bankruptcy notice, the period for response has been extended from 21 days to 6 months.
- If a person declares an intention to enter bankruptcy voluntarily, the period of protection afforded from creditor action has been extended from 21 days to 6 months.

An additional part of the relief provided by the Package includes the Federal Government advising that the Deputy Commissioner of Taxation will consider withholding enforcement action in relation to its wind ups and Director Penalty Notices. It should be noted that the Deputy Commissioner of Taxation has recommenced its recovery of debt, albeit, in a very limited capacity.

Another important amendment to the Corporations Act has been the temporary relief that a director can rely on pertaining to insolvent trading. A director has an obligation to prevent a company from trading whilst insolvent. A liquidator can recover an amount from a director personally if the liquidator can prove the company was insolvent and recover the value of the debts incurred during the time the company was insolvent to the date the company enters liquidation. This amnesty is dealt with in more detail in our Fact Sheet: [‘Director Duties, Insolvent Trading and You’](#).

The above reforms are part of the temporary measures as at the date of this Fact Sheet and are valid to 31 December 2020. It should be noted however, that the amnesty is seemingly only afforded to directors if they place the company into liquidation prior to 31 December 2020.

The Federal Government has recently announced changes to the Corporations Act 2001, to become effective 1 January 2021, pertaining to new forms of external administrations. The changes are:

- A director lead administration with a view to enable a company to continue to trade and put forward a debt restructuring plan to its creditors.
- A simplified liquidation process whereby the usual regulatory and investigative role of the liquidator is reduced.

The above is still in its infancy and further details are yet to be released by Government as to the specifics of the legislation.

Options for entities during the current climate:

Companies and sole traders who are facing financial distress during the COVID-19 pandemic do have options available to them to ensure the long-term viability of their business. These options are a range of informal or formal agreements with their creditors, including but not limited to:

- *Do nothing* – the abovementioned economic support package has effectively provided a hiatus for individuals and companies from recovery action by creditors and insolvent trading up to 31 December 2020 and this should be considered on a case by case basis.
- *Negotiate with creditors* - an informal arrangement whereby a business enters into an arrangement with creditor/s to pay an amount which is affordable and time specific. In exchange the creditor may provide an undertaking not to commence recovery action of a debt.
- *Enter Safe Harbour* – Appoint a specialist to ensure a company has a reasonable financial plan in place to ensure the long term prospects of the company, the directors inform themselves of the financial position of the company, meet financial record keeping obligations and meet its obligations in relation to employee entitlements and tax and has lodged all its tax returns, (including BAS) within the necessary timeframes. Safe Harbour provides comfort for directors that they can continue trading a company without the concern of insolvent trading.
- *Voluntary Administration* – A director appoints an Administrator to make a decision to determine the long-term future of the company. This will include either, handing the company back to the director (rare), the company entering Liquidation, or creditors accepting a Deed of Company Arrangement (DOCA). A DOCA is an agreement with the creditors which may compromise debts owed and these creditors be repaid on a cents in the dollar amount. A DOCA can also ‘buy time’ on the repayment of debt to creditors.
- *Liquidation* – A terminal wind up of a company. Outstanding debts will be paid in accordance with the necessary priorities under Section 556 of the Corporations Act. Upon finalisation of a liquidation, the company will be deregistered by the Australian Securities and Investments Commission.

There are also formal arrangements under the Bankruptcy Act 1966 pertaining to Personal Insolvency Agreements and Bankruptcy which are similar to those explained above. This is relevant for sole traders or those individuals who are partners of a partnership.

The need for, and risks associated with not, seeking expert advice in matters of corporate insolvency is fully explained in the resource prepared for us by the Australian Restructuring, Insolvency & Turnaround Association (ARITA): <https://www.cpaaustralia.com.au/-/media/corporate/allfiles/document/training/dealing-with-financial-distressv02?la=en&rev=d20580707dbe4fb6b68d1d0615801c74>

Information correct at time of publishing.