

OPTIONS FOR CLIENTS IN FINANCIAL DISTRESS

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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.

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

Members need to be aware that the temporary support and amnesty in relation to insolvency provided during the COVID-19 period of 2020 expired on 31 December 2020. Effective from 1 January 2021 new insolvency measures were announced are included detailed below.

Options for entities who may be in financial distress:

Companies and sole traders who are facing financial distress as a result of 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 creditors. These options are summarized below:

- *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, ensure the company meets 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. Insolvent trading is dealt with in more detail in our Fact Sheet: [‘Director Duties, Insolvent Trading and You’](#).

- *Temporary Restructuring Relief* – A director of a company can elect to take a three month relief period to appoint a Small Business Restructuring Practitioner (see below). Election is only available to 31 March 2021. This option means that if the election is made, the statutory demand amount is increased to \$20,000, the company has 6 months to respond to a statutory demand and there is also a benefit of temporary safe harbor from insolvent trading. This was introduced if the director is having difficulty securing the services of a Small Business Restructuring Practitioner.
- *Small Business Restructure* – A director lead process where you look to settle the debts owing to the creditors by proposing a Restructuring Plan. The director continues to trade the company whilst formulating a Plan to creditors to compromise the debts owed to creditors. There are eligibility criteria to propose this type of arrangement which are further explained [here](#).
- *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.
- *Simplified Liquidation* – Similar to the above ‘Liquidation’. This is designed to be a cheaper liquidation for your client. The point of difference lies in the eligibility criteria and the conduct of the officers of the company prior to the appointment of the Liquidator. Further explanation on this model can be found [here](#).

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>

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