



TAYLOR WOODINGS

NEWS FLASH

November 2009

Duty to prevent insolvent trading: ASIC draft guidelines for directors

On 24 November 2009 ASIC released draft guidelines on Insolvent Trading. Comments are to be submitted by January 22, 2010 [Consultation Paper 124](#).

Why these guidelines were released

ASIC has stated the guidelines were released to ensure directors understand their duty to prevent insolvent trading.

We consider it also signals to company directors and de facto directors an intention by ASIC to apply greater enforcement focus on insolvent trading. This could in turn lead to more prosecutions. It is essential your clients are aware of this important development.

The guidelines

The draft guidelines and discussion paper set out ASIC's view of the law, and their expectations as to how directors should conduct themselves. Relevant for advisers, the draft guidelines mention that the definition of directors includes persons who are not formally appointed as a director.

"The duty not only applies to persons who are formally or validly appointed as a director but also to persons who act in the position of director, or in accordance with whose instructions or wishes the company's directors are accustomed to act."

In detailing the purpose of the draft guide it is stated:

"The guide is intended to provide guidance to directors to help them understand and comply with their duty to prevent insolvent trading. It discusses:

- (a) The relevant legal background to the director's duty to prevent insolvent trading;
- (b) The following four principles which we consider directors should follow when endeavouring to meet their obligation to prevent insolvent trading:
 1. Directors must keep themselves informed about the company's financial affairs, and regularly assess the company's solvency;
 2. Directors should investigate financial difficulties immediately they identify concerns about the company's financial viability;
 3. Directors should seek appropriate professional advice to help address the company's financial difficulties; and
 4. Directors should consider and act appropriately on the advice received, in a timely manner; and

More information

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- (c) Some of the factors we will take into account in assessing whether directors have contravened the Corporations Act by allowing a company to trade while insolvent, in light of the key principles set out above.”

It is noted that in circumstances of dishonesty (S588G(3)) the sanction for insolvent trading can be a criminal offence with a maximum five year jail sentence.

An appendix to the draft guidelines lists indicators of potential insolvency. We set this out in full as a useful reference tool.

Factors to take into account in determining whether a company is insolvent Indicators of potential insolvency

- The company has a history of continuing trading losses.
- The company is experiencing cash flow difficulties.
- The company is experiencing difficulties selling its stock, or collecting debts owed to it.
- Creditors are not being paid on agreed trading terms and/or are either placing the company on cash-on-delivery terms or requiring special payments on existing debts, before they will supply further goods and services.
- The company is not paying its Commonwealth and state taxes when due (e.g. Pay-as-you-go instalments are outstanding, Goods and Services Tax (GST) is payable, or Superannuation Guarantee Contributions are payable).
- Cheques are being returned dishonoured.
- Legal action is threatened or commenced against the company, or judgements are entered against the company, in relation to outstanding debts.
- The company has reached the limits of its funding facilities and is unable to obtain appropriate further finance to fund operations—for example, through:
 - Negotiating a new limit with its current financier; or
 - Refinancing or raising money from another party.
- The company is unable to produce accurate financial information on a timely basis that shows the company’s trading performance and financial position or that can be used to prepare reliable financial forecasts.
- Company directors have resigned, citing concerns about the financial position of the company or its ability to produce accurate financial information on the company’s affairs.
- The company auditor has qualified their audit opinion on the grounds there is uncertainty that the company can continue as a going concern.
- The company has defaulted, or is likely to default, on its agreements with its financier.
- The company’s financier has appointed an investigative accountant to advise the financier about its funding exposure to the company.
- Employees, or the company’s bookkeeper, accountant or financial controller, have raised concerns about the company’s ability to meet, and continue to meet, its financial obligations.
- It is not certain that there are assets that can be sold in a relatively short period of time to provide funds to help meet debts owed, without affecting the company’s ongoing ability to continue to trade profitably.
- The company is holding back cheques for payment or issuing post-dated cheques



The late payment of taxes and superannuation is a relevant occurrence we see increasingly. There seems to be a belief that these debts can be delayed because the ATO will enter into payment arrangements. However until a payment arrangement is in existence the debts are due and could be a very relevant factor in determining a company's solvency.

How Taylor Woodings can assist

Taylor Woodings has extensive experience with formal and informal insolvency assignments. Across all appointments, we work hard to find practical solutions to the challenging situations faced with the aim of maximising returns for all stakeholders.

Ways in which we can assist in regards to the area of insolvent trading is to provide advice on:

- Whether it is likely a company is insolvent or near insolvency;
- What steps can be taken (if any) to avoid the company becoming insolvent;
- If insolvency cannot be avoided or it appears imminent we can assist directors to act in a way that appropriately discharges their duties.

If you wish to have a confidential discussion about any matter raised in this newsletter, please contact one of our Taylor Woodings' partners in Sydney, Perth or Melbourne.

Disclaimer:

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