



Session 5

Insolvency activity

*Rob Woods,
Craig Rosenberg
& Michael Quin
Deloitte Australia*

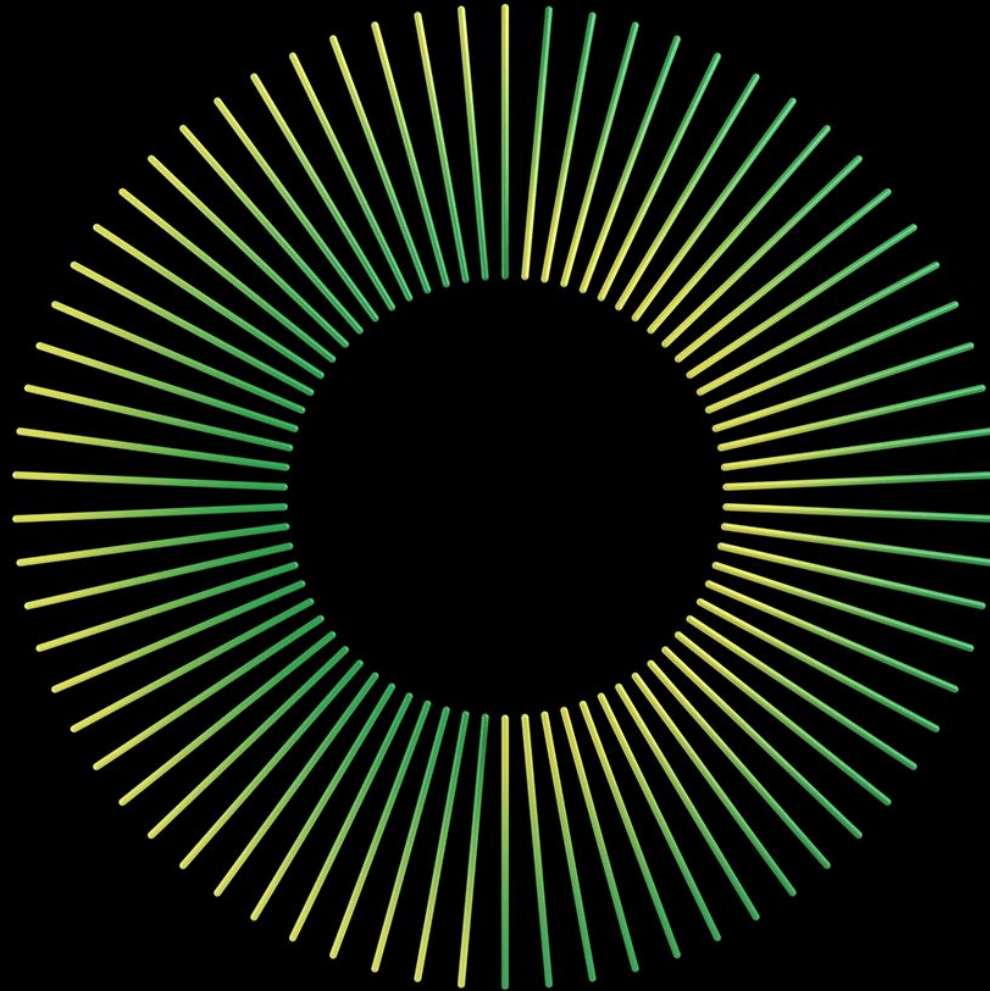


Insolvency Activity & Current Triggers

2022 Pickles IMA Conference

Rob Woods, Michael Quin
& Craig Rosenberg

12 August 2022

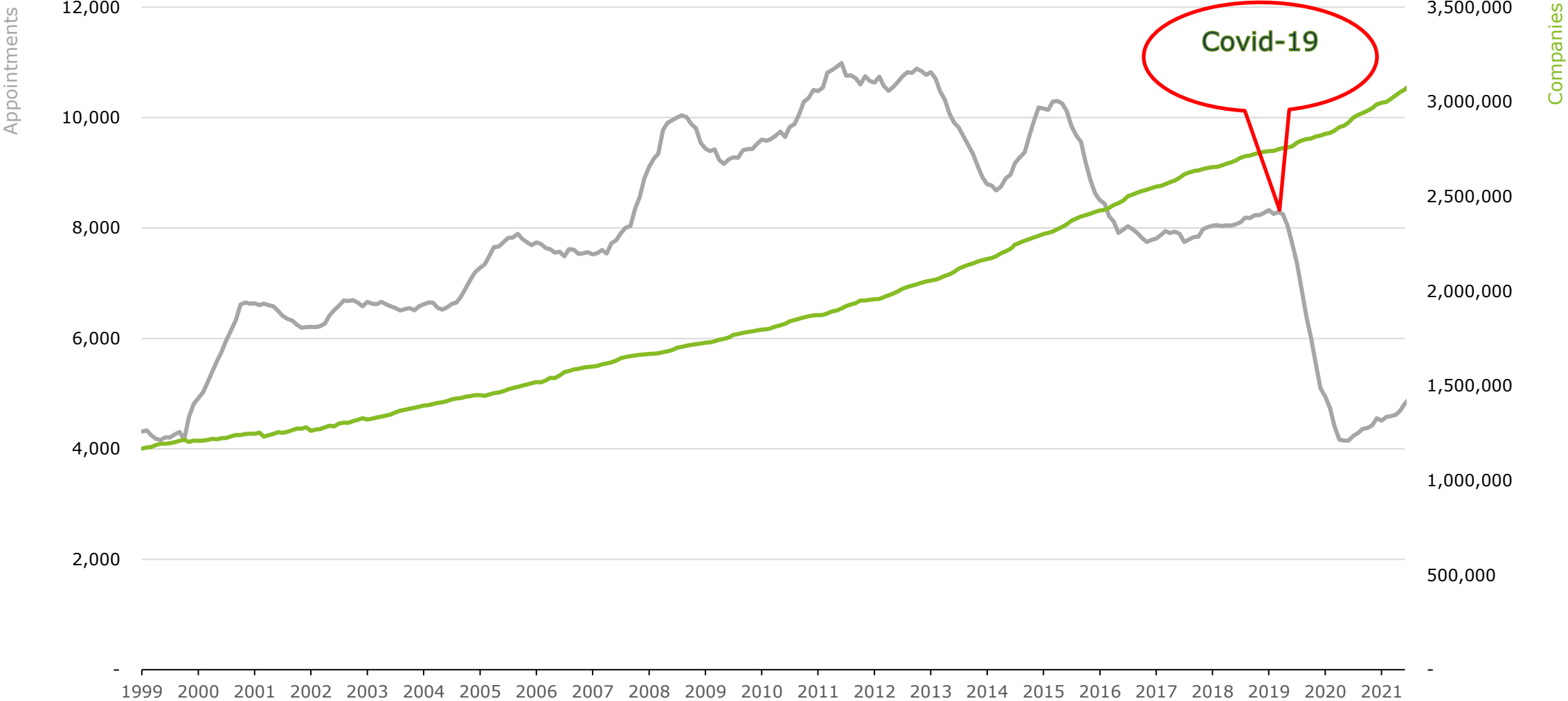


Agenda

- | Restructuring & insolvency activity
- | Insolvency & common triggers
- | What is driving current insolvency appointments
- | Questions

Restructuring & insolvency activity

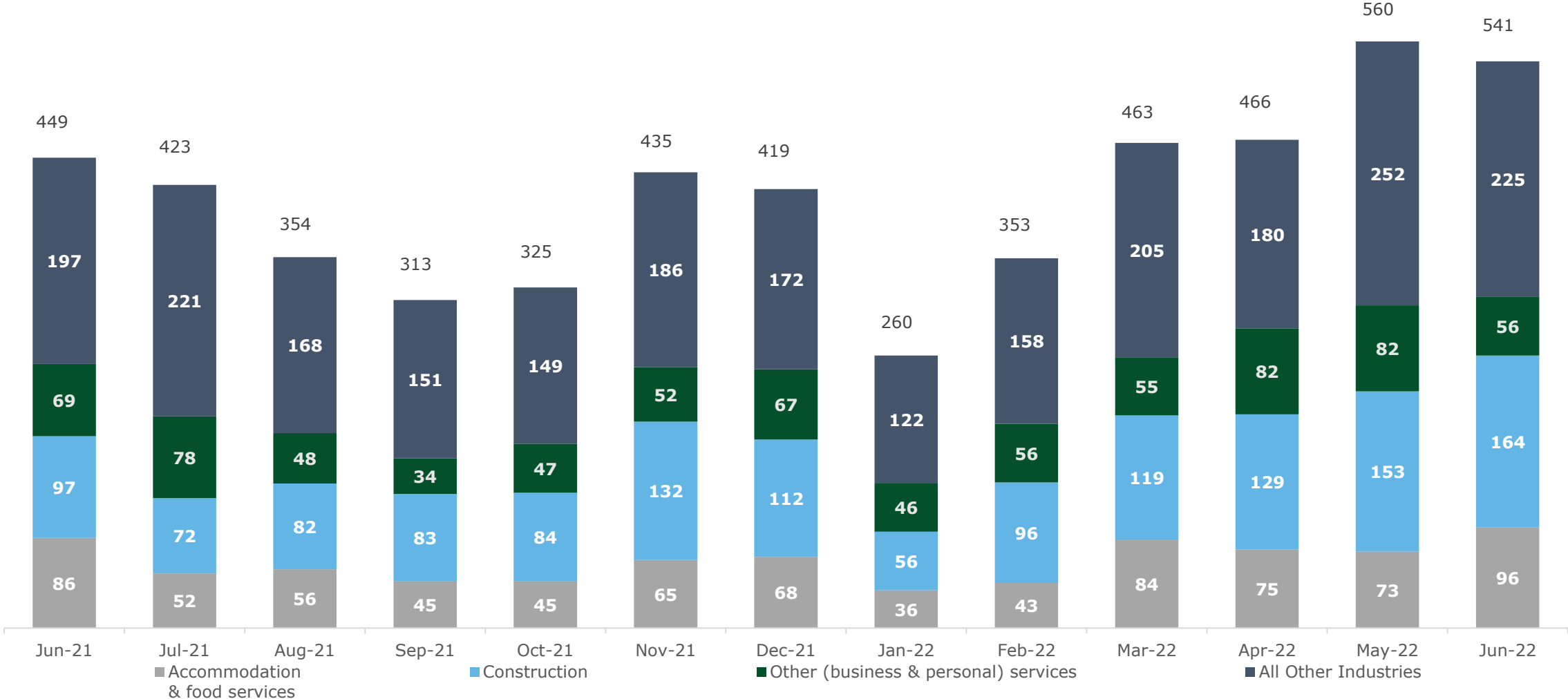
Corporate insolvency appointments



Source: ASIC website

— Rolling Annual EXADs — Total Companies

Industry analysis



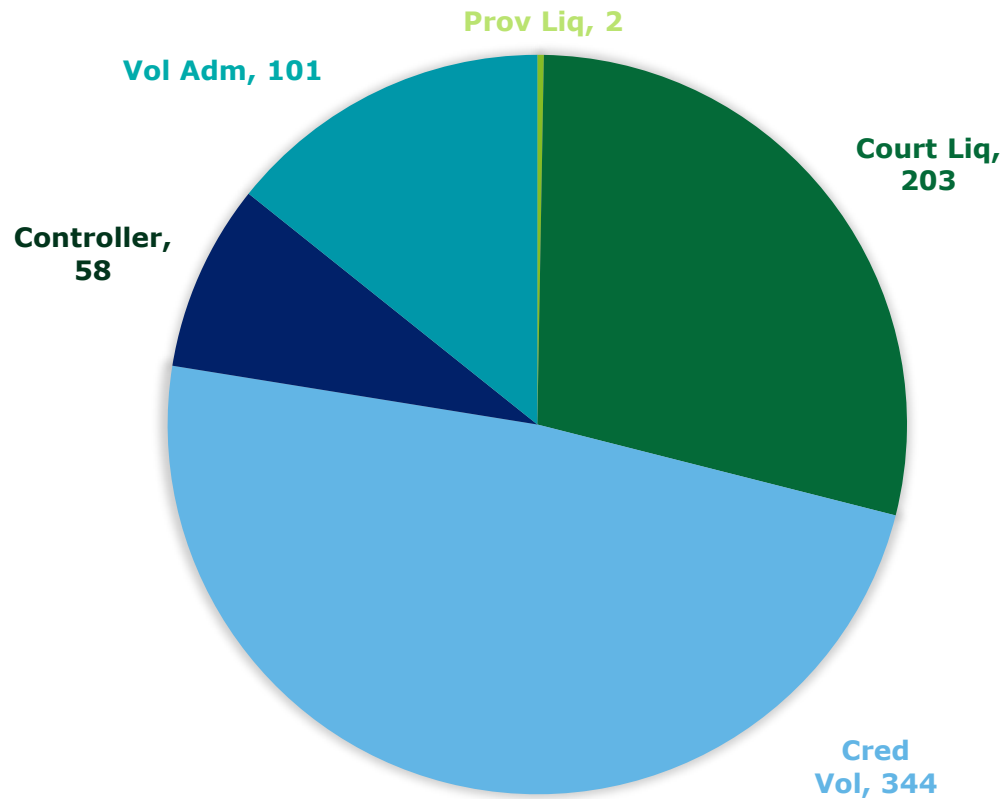
Source: ASIC website

Then and now

Are appointment numbers beginning to normalise?

June 2019:

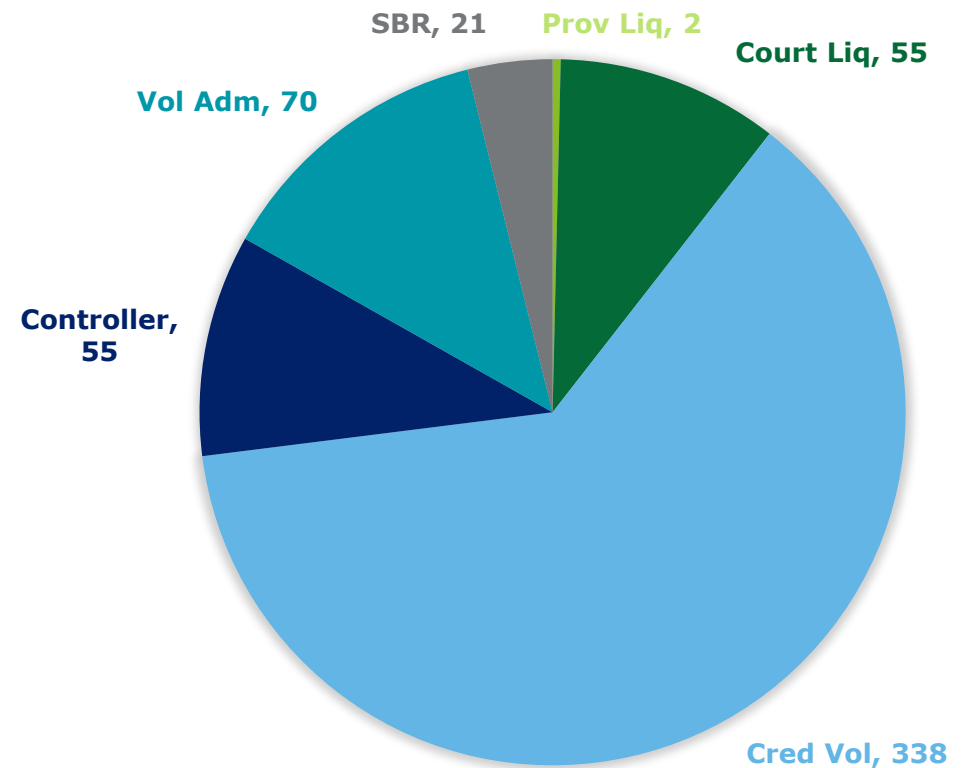
708 corporate insolvency appointments



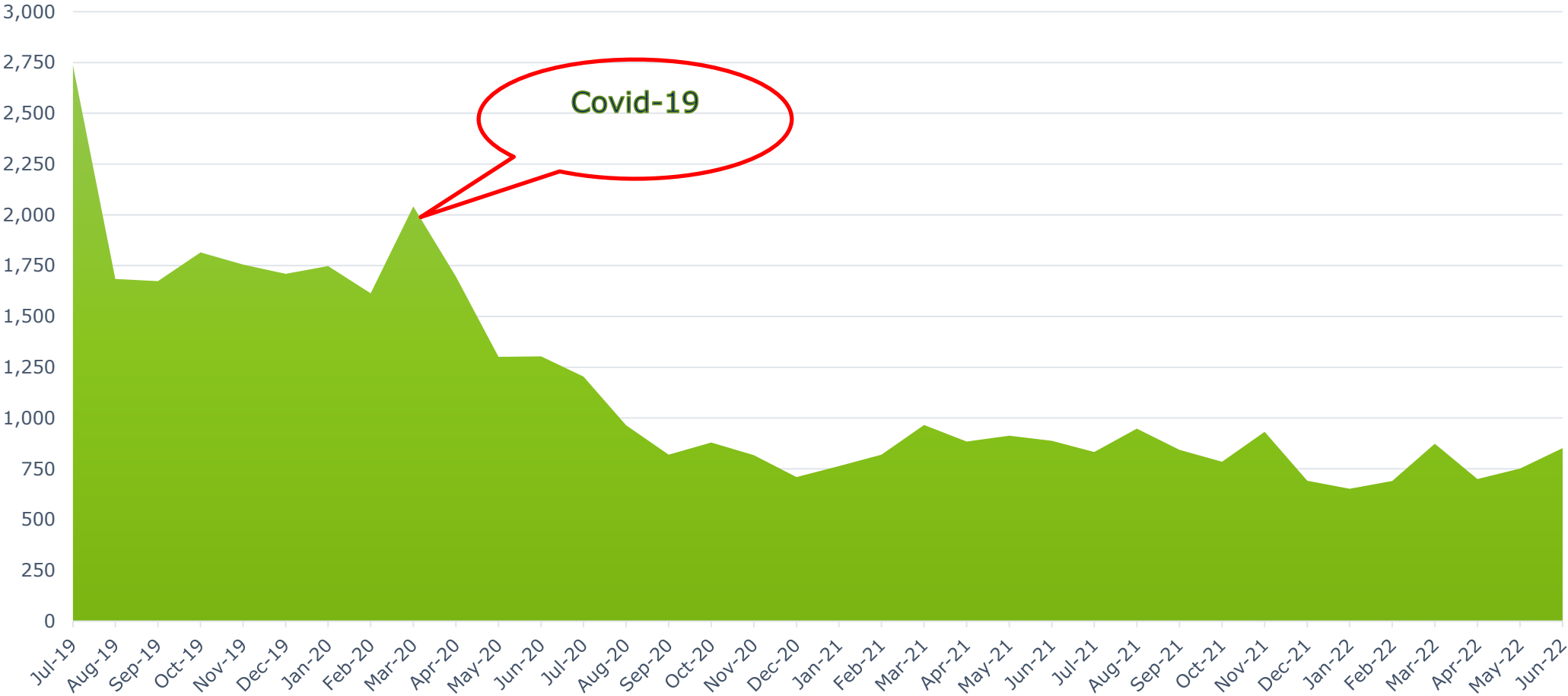
Source: ASIC website

June 2022:

541 corporate insolvency appointments



National personal insolvencies



Source: AFSA website

Insolvency & common triggers

Defining solvency

Determine when a company is insolvent



When is a company insolvent?

01

Legal Definition

s95A of the Corporations Act 2001 (Cth):

- (1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable; and
- (2) A person who is not solvent is insolvent.

02

Case Law

ASIC v Plymin [2003] 46 ASR 126 established the commonly regarded indicators of insolvency:

1. Continuing losses
2. Liquidity ratio below 1.0
3. Overdue Commonwealth and State taxes and statutory obligations
4. Poor relationship with present bank including inability to borrow additional funds
5. No access to alternative finance
6. Inability to raise further equity capital
7. Supplier placing the debtor on cash-on-delivery (COD) terms, or otherwise demanding special payments /arrangements before resuming supply
8. Creditors unpaid outside trading terms
9. Issuing of post-dated cheques
10. Dishonoured cheques
11. Special arrangements with selected creditors
12. Payments to creditors of rounded figures, which are irreconcilable to specific invoices
13. Solicitors' letter, summon(es), judgments or warrants issued against the company
14. Inability to produce timely and accurate financial information to display the company's trading performance and financial position, and make reliable forecasts

Insolvency Practitioners are required to **report any potential misconduct** they identify in the course of their investigations to ASIC.

Other indicators of insolvency

Different industries, different indicators

Retail

Declining sales, fixed or increasing cost base, surplus and obsolete inventory, negative social media, global and online competition, continual wage increases, and onerous lease obligations.

Construction

Materials costs, underquoting, cost over-runs, unapproved variations, unrecoverable retentions, diversification beyond experience, profits locked up in disputes, and site closures.

Agribusiness

Seasonal conditions affecting crop or livestock, export tariffs, decrease in demand for product (domestically and internationally), and a decline in quality of crop or livestock due to disease or other factors.

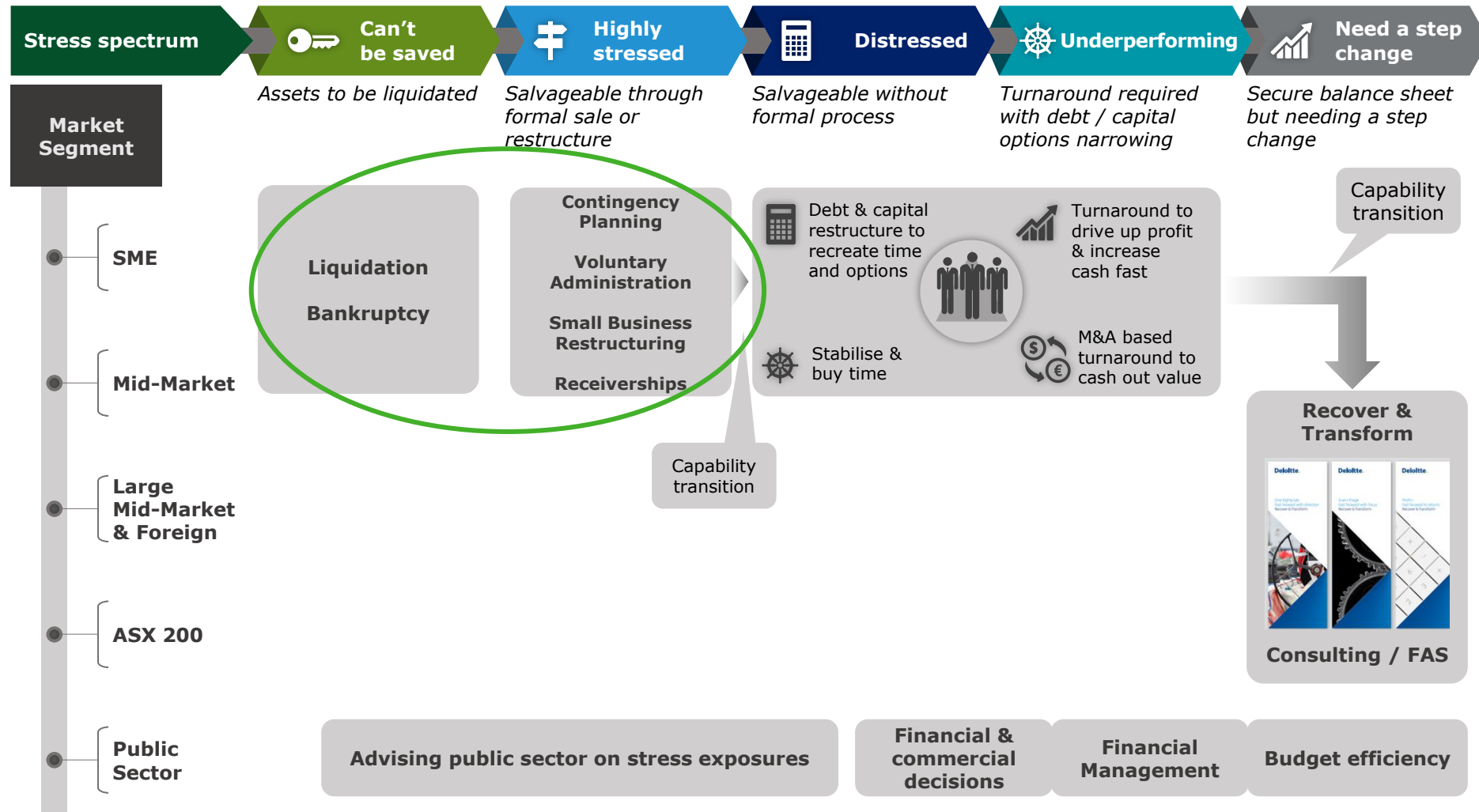
Manufacturing

Unfavourable credit terms, decline in number and value of orders, high scrap rates, and union disputes

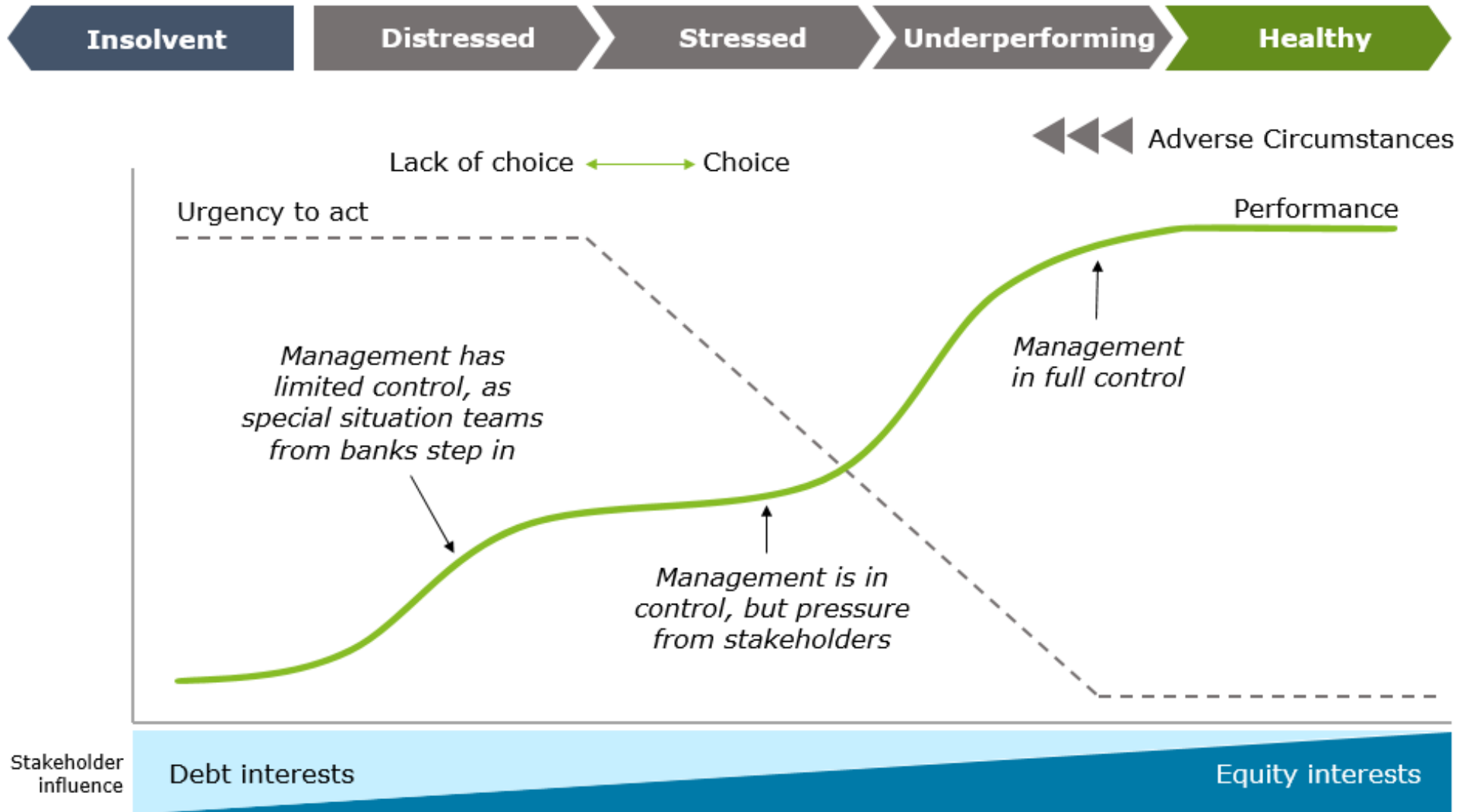


Stress spectrum

SME and mid-market businesses



Timeline for intervention



Formal corporate & personal insolvency

Voluntary Administration (VA)	Deed of Company Arrangement (DOCA)	Small Business Restructuring (SBR)	Liquidation	Bankruptcy
<p>Typically appointed by Directors because the company is insolvent or likely to become insolvent.</p> <p>Objective of VA: <i>"... to maximise the chances of the company, or as much as possible of its business, continuing in existence... or a better return for the company's creditors than would result from a winding up..."</i></p> <p>A VA is a very short term engagement: 25 business days max. (but creditors can agree to extend it a further 45 business days) or the Court may extend.</p> <p>Typically a trade on, investigate the situation and report to creditors. The creditors must decide the future of the company and they have three options:</p> <ol style="list-style-type: none"> 1. That it be wound up (i.e. appoint liquidators) 2. That a proposal, if any, (a Deed of Company Arrangement – DOCA) be accepted 3. That the VA ends (Directors resume control). Very rare. 	<p>Only available following a VA if the directors proposed a DOCA and the majority of creditors resolved to accept it. All creditors bound by the DOCA, even those who voted against it.</p> <p>Objective: Creditors get more c/\$ from the DOCA than liquidation would yield.</p> <p>We transition from VA to Deed Administrator and we collect/sell/manage/supervise as per the terms of the DOCA.</p> <p>Examples of what a typical DOCA might propose:</p> <ul style="list-style-type: none"> • Directors' resume control and the company pays instalments (out of future profits) to the Administrator for distribution amongst creditors • Members contribute extra money, which becomes a deed fund • We retain control, sell the business PLUS directors pay additional sum to guarantee xc/\$ for creditors. 	<p>Appointment by directors because company insolvency or likely to become insolvent. Subject to eligibility criteria, e.g. liability test <\$1million.</p> <p>Fundamentally same restructuring objectives as a voluntary administration however streamlined legal framework to make process less costly and more accessible to small businesses.</p> <p>Unlike VA, debtor retains control of business and assets, thus avoiding the risk and costs of trading as might be incurred in a VA.</p> <p>Default timeframe of 35 business days during which time company can follow framework to propose 'restructuring plan' which is essentially a compromise with creditors. Comparable to a DOCA, though less flexible.</p> <p>Creditors determine outcome. If restructuring plan rejected, process ends and status quo resumes. Unlike VA, creditors cannot resolve to wind up the company.</p>	<p>Three types of liquidation, all defined by the way we are appointed, but practical process is the same</p> <p>We take control of the company, sell/realise the assets and distribute the proceeds to the creditors in the order that they rank.</p> <p>If a business is operating, we usually trade it (for a limited period) to sell as a going concern.</p> <p>Additional duty to investigate which may lead to legal proceedings to recover assets /claims for the benefit of the creditors.</p> <p>Corporations Act give liquidators very wide powers to recover assets/moneys stripped from the company.</p> <p>At the end of the winding up, it gets deregistered and will cease to exist.</p>	<p>Similar to appointment of liquidator over a company (i.e. realise assets and distribute amongst the creditors).</p> <p>Appointee is the trustee of the bankrupt's estate.</p> <p>When the bankruptcy ends (approx. 3 years), outstanding debts are wiped and individual is "discharged"</p> <p>Part IX Debt Agreement</p> <p>Objective is to give the creditors more than they'd get if they bankrupted the insolvent. E.g. if bankruptcy would yield 10c/\$, the insolvent might promise up 15c/\$.</p> <p>Personal Insolvent Agreement (PIA)</p> <p>Similar to Part X, but no debt or asset/income limits to be eligible. Must appoint trustee and cover their costs.</p> <p>Insolvent can retain assets (such as house or car) if the terms of the PIA allow.</p>

Safe Harbour

Safe Harbour background

- Safe Harbour regime came into effect in September 2017 and is currently subject to government review
- Allows directors some protection from the insolvent trading liability under s588G while they attempt a restructure, if they develop a course of action 'reasonably likely to lead to a better outcome for the company' (for example better than immediately appointing an administrator or liquidator)
- Safe harbour commences when a director starts to suspect the company may become or is insolvent and starts developing the course of action
- Directors must continue to pay employees, report taxes and comply with other duties
- If a developed course of action isn't reasonably likely to succeed an Administrator/Liquidator will be appointed.

Cessation of Safe Harbour

Safe harbour ceases when:



Safe Harbour considerations

The burden of proof is on the director

- Legislation provides indicia:
 - i. Informed of company's financial position
 - ii. Prevent any misconduct
 - iii. Appropriate financial records
 - iv. Obtaining advice
 - v. Plan for restructuring (cannot be a passive approach)

Decided course of action must be "reasonably likely"

- Must not be 'fanciful' or 'remote' however does not require a 50/50 chance of success
- Can change strategies along the way
- Can incur losses (e.g. asset realisation) or result in a worse outcome
- Assessed when decision is made

Safe harbour does NOT apply if the company does not

- Pay its employee entitlements on time; or
- Comply with its obligations under taxation law (e.g. lodging returns); or
- Provide books and records during a subsequent external administration

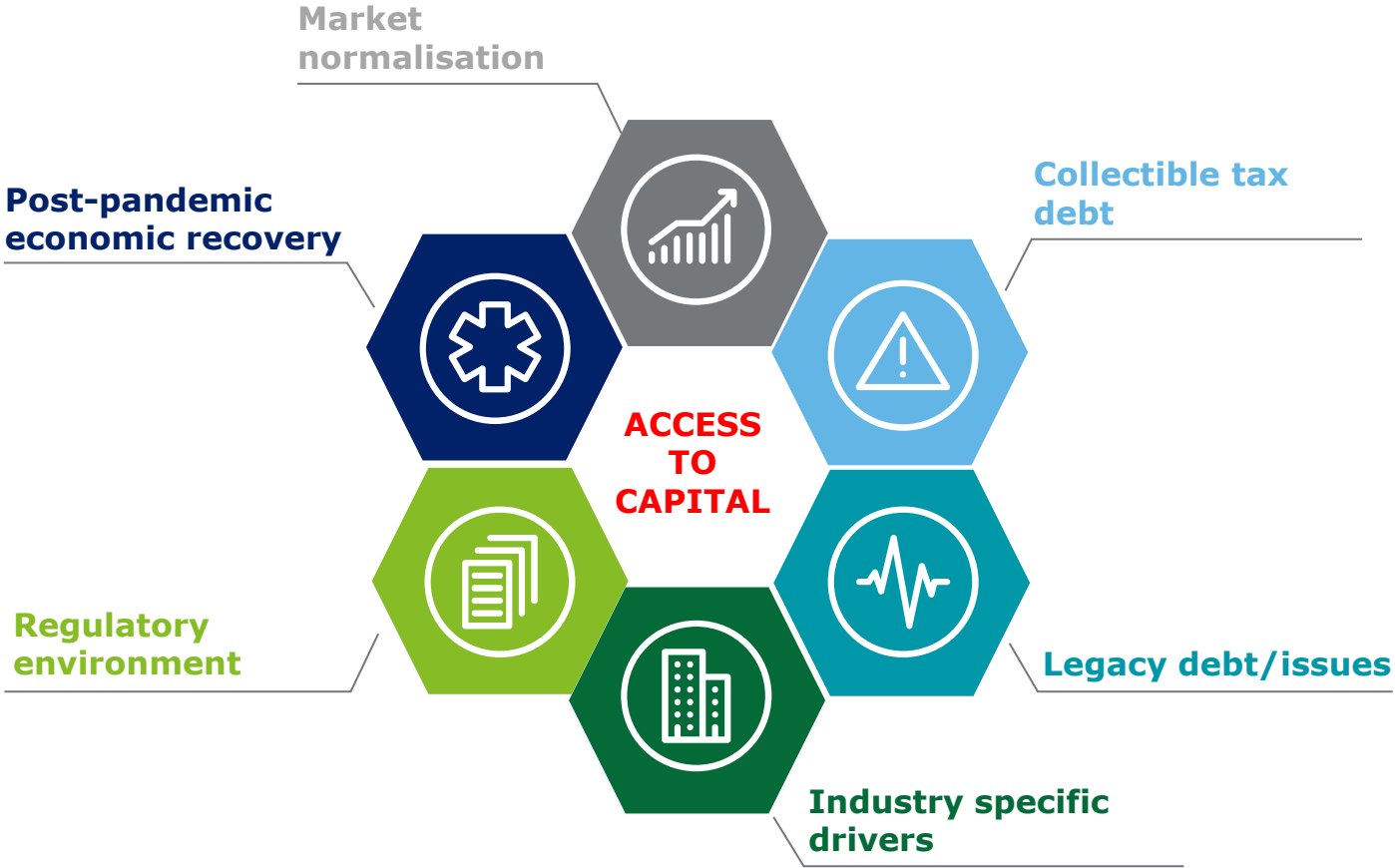
Not all debts are covered

- Only those which:
 - i. Relate to the course of action
 - ii. Which are incurred during the action period).

What is driving current insolvency appointments

Key drivers

Mid-market turnaround, restructuring and insolvency



Australian Taxation Office (ATO)

The ATO is a key stakeholder

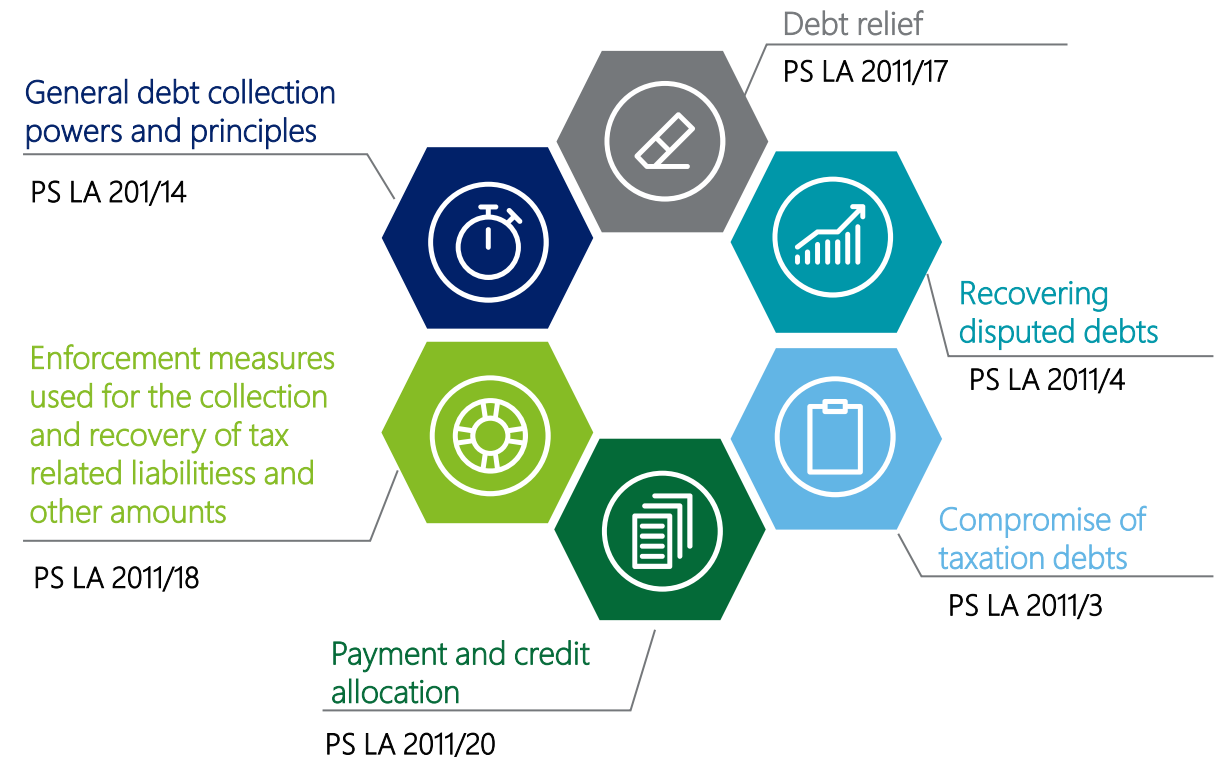
- With respect to SMEs, the ATO has historically been one of the primary drivers of insolvency appointments whether through direct or indirect enforcement action
- Anecdotally, the ATO is an actual or contingent creditor in a majority of formal appointments
- ATO has taken a light touch with debt recovery during the pandemic, however collection activity now increasing
- Collectible tax debts have increased to approximately \$40B and ATO is starting to increase recovery action. Limited formal action, focus on existing audits, reporting to credit agencies and warning notices

Payment arrangements

- Payment arrangements are discretionary and availability will depend on range of factors, including compliance history and solvency of taxpayer
- Payment terms for up to three years, but ATO will push for debt to be paid in shortest timeframe possible
- ATO may request financials, debtors ledger and other relevant information. Taxpayer may be required to complete Business Viability Assessment Tool
- ATO may seek personal guarantee from director and take security over company and third party assets (typically mortgage over real property)

Recovery and enforcement action

- ATO recovery and enforcement action has improved considerably in recent years due to advancements in data matching, programs, analytics capability and inter-departmental communications
- ATO recovery and enforcement action undertaken in accordance with Receivables Policy, which is broken down into a series of Law Administration Practice Statements (LAPS) that are available on the ATO website. Examples of areas covered by the LAPS are detailed below.



ATO recovery action (ex DPNs) and key considerations

Forms of recovery action by ATO

Disclosure of business tax debts:

- Businesses that meet certain criteria may have their tax debts disclosed to credit reporting bureaus (CRBs).
- Criteria are: taxpayer has an ABN and not an excluded entity (e.g. DGR), tax debts of at least \$100,000 overdue by more than 90 days, not engaging with ATO to manage debt, no active complaint with the Inspector-General of Tax Ombudsman
- Disclosure preceded by Notice of Intent to Disclose providing 28 days to take necessary action

Garnishee notice:

- Notice to a third party that holds money for a taxpayer, or may hold money for you in the future, directing them to pay those funds to the ATO in reduction of the tax debt
- Commonly issued to taxpayer's financial institution, trade debtors and suppliers of merchant card facilities.
- Funds recovered under notice protected by statutory charge

Statutory demand (precursor to winding up):

- Issued to a company under Corporations Act in respect of debts totalling at least \$4,000 (up from \$2,000 as of 1 July 2021)
- 21 days to pay, otherwise presumed insolvent in subsequent winding up application
- Significant body of case law surrounding service and setting aside demands. Impact of changes to laws relating to electronic delivery may need to be considered
- Bankruptcy Notice the equivalent of a statutory demand but for an natural person. Must be in respect of debt of at least \$10,000 and be supported by a judgment. Significant procedural differences compared to a statutory demand

Key considerations and other takeaways



A successful turnaround or restructuring program for SME typically requires support from the ATO



Compliance with reporting obligations a key factor in ATO support and managing personal exposure for director



Engagement with ATO is critical. Ensure contact details are current and all correspondence is reviewed and addressed



Superannuation obligations likely to remain a critical compliance issue. Onerous penalties for breaches



Non-compliance risks for clients transacting in crypto-currency

Director Penalty Notice (DPN)

Div 269 Schedule 1, Tax Administration Act 1953

What is a Director Penalty Notice?

- A DPN is a penalty imposed by the Commissioner of Taxation (CoT) on a director for the amount equal to the PAYG, net GST liability (inclusive of LCT and WET) or SGC owing by their company.
- The CoT has the discretion to issue a DPN. They are not automatically issued.

Director responsibilities

- Responsible for making sure the company meets its PAYG withholding, net GST and SGC obligations.
- If a company fails to meet a PAYG withholding, net GST or SGC liability in full by the due date, a director is personally liable for director penalties equal to the unpaid amounts.
- Director has 21 days to take the following action to remit the penalty, otherwise they may be subject to direct enforcement action by the CoT:
 - For PAYG and net GST liabilities reported within 3 months of due date and SGC reported by no later than due date, penalty can be remitted in full by paying the tax debt or appointing a voluntary administrator, liquidator or small business restructuring practitioner. A DPN in respect of these liabilities referred to as a 'Non-lockdown DPN'.
 - For PAYG and net GST liabilities reported more than 3 months after due date or SGC reported after due date, the only way to remit the penalty is to pay the debt. A DPN in respect of these liabilities referred to as a "Lockdown DPN".



Remission of 'Non-lockdown' penalty by a payment plan withdrawn

New directors have 30 days, starting on the day of their appointment, before they become liable to director penalties equal to:

- all of the company's unpaid PAYG withholding liabilities
- all unpaid net GST liabilities (inclusive of LCT and WET) from 1 April 2020;
- all unpaid SGC liabilities from 1 April 2012.

Key Tips:

- i. Directors need to ensure tax debts are reported to the Commissioner in a timely manner
- ii. Clients facing liquidity issues should be engaging with the ATO early to discuss possible options available (i.e. payment plan)
- iii. New directors need to ensure the company's tax affairs including unpaid amounts are up to date including superannuation or they could become personally liable.

Credit risk triggers

Borrower transferred to internal credit risk team:

A client in financial distress may have the management of their facilities transferred to the lender's internal credit risk team.

The credit risk team will take steps to better understand the strategies available to the borrower, which may include security realisation and exit strategies. To that end, most credit risk teams will classify a customer as 'exit' or 'retention' and will manage the file until:

- An agreed strategy has been executed and, if the borrower has been retained, there has been a satisfactory period of compliance, or
- Security held by the lender is fully realised and enforcement action completed, and
- The debt has been refinanced.

Examples of triggers for transfer:

- Repayments have been outstanding for an extended period of time (e.g. over 90 days)
- A garnishee notice is received from the ATO
- Facilities overdrawn repeatedly
- Review indicates that loan covenants breached (e.g. LVR)
- Failure to renegotiate facilities on maturity
- A winding up application is filed against the borrower or it becomes subject to a formal insolvency appointment

Questions?

Deloitte Black Ink member program

Black Ink is a member network of professional (including legal), financial and advisory firms.

As a member you will have access to Deloitte's people and resources on array of topics; whether it is simply to get a second opinion or something outside of your field of expertise, allowing you to focus on your key strengths, core business and build stronger client relationships.

Deloitte supports the Black Ink member network by providing:

- **Black Ink technical updates and newsletters** – we will send you regular informative newsletters on topical and technical issues
- **Seminars, webinars and training** – seminars and training sessions on a wide variety of topics that can be adapted to suit a particular group by request
- **Networking functions** – build relationships within the Black Ink network by attending seminars and functions.

Membership to the Black Ink program is free.

Further information about the program including registration can be found:

<https://www2.deloitte.com/au/en/pages/finance/solutions/black-ink.html>

Deloitte.

Deloitte Turnaround & Restructuring Services delivers unique insights and innovative solutions to the impacts of disruptive forces on capital requirements, risk and performance.



Robert Woods
Partner

Liquidator | Bankruptcy Trustee

robwoods@deloitte.com.au
(03) 9671 6432



Michael Quin
Principal

Liquidator

mquin@deloitte.com.au
(03) 9671 7938



Craig Rosenberg
Director

croseberg@deloitte.com.au
(03) 6337 7059





Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms, and their related entities (collectively, the “Deloitte organisation”). DTTL (also referred to as “Deloitte Global”) and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our global network of member firms and related entities in more than 150 countries and territories (collectively, the “Deloitte organisation” serves four out of five Fortune Global 500® companies. Learn how Deloitte’s approximately 312,000 people make an impact that matters at www.deloitte.com.

Deloitte Asia Pacific

Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which are separate and independent legal entities, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

Deloitte Australia

The Australian partnership of Deloitte Touche Tohmatsu is a member of Deloitte Asia Pacific Limited and the Deloitte organisation. As one of Australia’s leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, risk advisory, and financial advisory services through approximately 8000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our web site at <https://www2.deloitte.com/au/en.html>.

Liability limited by a scheme approved under Professional Standards Legislation.
Member of Deloitte Asia Pacific Limited and the Deloitte organisation.