a brief guide to insolvency

A business is insolvent when it has more liabilities than assets (the balance sheet test) or cannot pay its debts when they fall due (the cash flow test). Once insolvent the director's duty changes from acting in the company's shareholders' interests to acting in creditors' interests. Various legal restrictions and potential recovery actions can apply after this point. If you are in business you can continue to trade as long as you take every step to minimise the loss to creditors.

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This guide is aimed at company directors and will take you through a "waterfall" of insolvency options from the least to the most severe, following the thought process you might go through when assessing what to do. You could liken this to a decision process that helps you avoid purchasing a new car when a repair will do.

trading out of difficulty

Avoid any type of insolvency process if you can, if it is realistic and you can do it without exposing yourself to personal liability. It is an obvious statement but if your company is loss making with negative cash flow, every day that goes by its finances get worse. Conversely if it is profitable with positive cash flow, every day that goes by its finances get better. So if you can identify why your company has got into financial difficulty, work out how it can avoid repeating these mistakes and have a credible plan to build a successful business, then your best bet will be to trade out of difficulty. **Our top tips:**

- Prepare management accounts to show what went wrong.
- Work out whether the reasons are a one off or can be avoided in the future.
- Understand where your company makes and loses money. If possible focus sales on the most profitable services/products.
- Prepare financial forecasts preferably integrated profit and loss, cash flow and balance sheets at monthly rests for at least 12 months.
- Prepare regular management accounts and monitor progress against your plan.

Two words of warning: Make sure your plans are **realistic** and remember to focus on **cash flow** - many a profitable business has failed because it has run out of cash.

informal arrangement

If you cannot make the cash flow ends meet then you could try to negotiate time to pay with creditors. This could just be with a few major creditors or with all your creditors – but if you have more than half a dozen creditors the latter is notoriously difficult as it only takes one creditor to break ranks. A time to pay agreement with HMRC can be very effective. If your company is not a serial tax payment offender you can expect to get between three and six months time to pay but if you miss a monthly payment the consequences are likely to be severe. **Our top tips:**

- Approach HMRC with a time to pay proposal before they chase you. Have a short term cash flow forecast ready to show that the proposal is credible.
- If possible have some cash put aside to start the time to pay proposal with an immediate payment on account – as money talks.
- If appropriate consider joint ventures with key suppliers willing to extend credit for a share of the profit.

A word of warning: Trade creditors can get greedy and demand a high price or withdraw credit altogether – making a bad situation disastrous. So informal arrangements work better with HMRC or suppliers you know well.

company voluntary arrangement

This is a formal insolvency procedure governed by the Insolvency Act 1986. It is the closest thing we have to Chapter II in the USA leaving the directors in charge of the company whilst an Insolvency Practitioner supervises the proposal (contract) with creditors. If approved by 75% of unsecured creditors by value then all creditors are bound. The proposal can be as flexible as you like – just like any other contract – however creditors usually call the shots and most CVAs either provide for creditors to receive 100 pence in the pound or require monthly voluntary contributions for five years. **Our top tips:**

- If HMRC is a major creditor you will probably have to adopt its standard approach terms, which can be quite restrictive. Make sure you understand what they are before committing.
- Five years is a long time. Many CVAs fail either because creditors impose unrealistic conditions or something changes – your health, the economy or some other business fundamental. So be realistic.

- Typically you will be expected to remit pretty much every penny of profit for the next five years or pay creditors in full. Do not agree to this without understanding whether another insolvency option might be more suitable. If the proposal is going to work it should benefit you and creditors alike.

- Not all Insolvency Practitioners see CVAs the same way. Some will push for every last penny for creditors and some will adopt a balanced approach. Fight your own corner and if in doubt get a second opinion.

- Also, some Insolvency Practitioners impose more conditions and constraints on directors than others. In our view directors should be left as free as possible to run their company without unnecessary interference. Remember, the proposal is just a contract and you should not agree to terms you are not comfortable with.

A word of warning: Many CVAs fail. Another insolvency procedure might suit you better.

administration

In theory administration can be used to provide breathing space to rescue a company. In that way it is sometimes known as a rescue procedure. However, in practice at best it is most commonly used to sell a company's business and assets as a going concern.

Most administrations are made by the directors using a quick and straightforward procedure. Debenture holders, typically a bank, can also appoint their choice of administrator. There is also a Court procedure which involves an application and a hearing.

Administrations are split between conventional and pre-packs. A pre-pack is where a sale of the business and assets is negotiated prior to and completed immediately after the administrator's appointment. These are heavily regulated, usually require the business and assets to be openly marketed and are probably one of the most difficult things Insolvency Practitioners do. Notably, the popularity of administrations over liquidation has reduced because:

- Employee liabilities transfer to the purchaser in administration sales but do not in liquidation sales.

- Pre-packs are much more heavily regulated.

- Under new (2017) insolvency rules the lead in time to liquidation is just as quick as to administration.
- If there are funds for unsecured creditors the company will need to go into liquidation anyway.

A word of warning: Administrations can be costly as there is usually significant pre-appointment work and following the appointment the administrators take over the running of the company.

voluntary liquidation

A creditors' voluntary liquidation is probably the most common – if you like the bread and butter – insolvency procedure. It is used when a company cannot trade on, and the assets need to be realised and the proceeds distributed to creditors. However, with the clarification a few years ago that TUPE does not apply in liquidations, it can and is used to effect sales of business and assets as going concerns.

It is called a voluntary liquidation as the procedure is voluntarily initiated by a company's directors and the appointment is then voluntarily made by shareholders. With the introduction of new rules in 2017 the process to get a company into liquidation now only takes five business days, half the time it used to. Like in administrations (but not CVAs) a liquidator has to submit information on directors' conduct and investigate the company's affairs. Common mistakes directors make include:

- Treating the company bank account like their own, lending to large director loan accounts that have to be repaid. These would usually be extinguished by declaring dividends but that is unlawful once the company is insolvent.
- They repay themselves and associated companies whilst not paying other creditors. These payments can be reversed as preferences.
- Continue to trade and run up more credit risking personal liability.

A word of warning: Choose your liquidator carefully. A liquidator has wide powers and you want to be sure they will exercise those reasonably.

compulsory liquidation

A compulsory liquidation is imposed on a company by a Court – usually on the application/petition of a creditor. The most prolific petitioning creditor is HMRC. It costs around £3,000 to petition so it tends to only be for larger debts. If a winding up order is made, the Official Receiver, a civil servant, is appointed liquidator.

Our top tips:

- It is best to take control and drive an insolvency process yourself rather than leave it to creditors.
- If you do not, creditors have a natural suspicion that you have something to hide. Also, you would not get your own choice of Insolvency Practitioner.
- Any payments made after a petition is filed at Court can be claimed as void dispositions although banks will quickly freeze the bank account.

A word of warning: The Official Receiver is targeted to get director disqualifications.

conclusion

This has been a whistle-stop tour of corporate insolvency processes. The main guide containing the principal legislation for insolvency professionals runs to 1,382 pages so all this guide can hope to do is point you in the right direction. However, it is no substitute for case specific professional advice, which we would be pleased to provide to you. Call us on 0800 085 5070 for a free no obligation initial meeting.

ps

There is another winding up process, which is for companies that are not insolvent at all - called a members' voluntary liquidation. This is also sometimes known as a solvent liquidation and is used when a company has come to the end of its life, creditors can be paid in full and there are funds to distribute to shareholders. This has to be conducted by an Insolvency Practitioner as there are provisions to convert it to a creditors' voluntary liquidation if necessary.

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Insolvency is not a DIY process and you should not try to do it yourself. Seek and follow independent professional advice. Your most important decision will be your choice of insolvency advisor, especially your choice of Insolvency Practitioner who takes control of your insolvency process. Whilst all Insolvency Practitioners are regulated, like advisors, they are not all equal! For the best available advice call 0800 085 5070.

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At McTear Williams & Wood our aim is to help you deal with a difficult situation, remove some of the stress and worry and obtain the best possible outcome for you. But early contact is the key. The sooner you get in touch the more we will be able to do to help.

For an informal free of charge telephone call contact

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