



ASIC

Australian Securities & Investments Commission

REPORT 213

National insolvent trading program report

October 2010

About this report

This report sets out the key messages and outcomes identified by ASIC's national insolvent trading program.

We expect this report to be beneficial to directors of companies, company advisers (including accountants and lawyers) and other interested stakeholders.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

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Executive summary

Overview of program

- 1 A key objective of the Australian Securities and Investments Commission's (ASIC) national insolvent trading program (NITP) was to encourage directors to seek professional advice at an early stage to address their company's solvency issues, or increase the likelihood of a return to creditors should the company enter into external administration.
- 2 The NITP also aimed to ensure directors were made aware of their director duties and to provide guidance to help them understand and comply with those duties.

Key outcomes

- 3 Via the NITP, ASIC:
 - visited over 1530 companies displaying solvency concerns during the period from 2005–06 to 2009–10;
 - provided an awareness of director duties and ASIC's expectations of professional advisers when companies are experiencing financial difficulties;
 - encouraged directors to seek advice from an insolvency professional about the appointment of an external administrator where significant insolvency indicators were identified; and
 - observed that 15% of companies reviewed by us were subsequently placed into external administration—mostly by the directors.

Key messages

- 4 A director is less likely to breach their duties under the *Corporations Act 2001* (Corporations Act) if they take into account the following key principles in carrying out their role:
 - maintain appropriate books and records;
 - identify insolvency concerns and assess available options;
 - seek professional advice; and
 - act in a timely manner.

A The national insolvent trading program

Key points

A key objective of the NITP was to encourage directors to identify insolvency indicators relating to their company and to seek professional advice at an early stage.

Directors seeking advice at an early stage may achieve a better outcome for external stakeholders, including employees and creditors.

Key indicators of insolvency include, but are not limited to, ongoing trading losses, cash flow difficulties, outstanding trade creditors and the inability to obtain further finance.

Background

- 5 The NITP identified companies showing signs of financial distress, or nearing insolvency, and encouraged directors to recognise those warning signs and seek appropriate professional advice at an early stage.
- 6 Since the NITP began in 2005–06, ASIC visited directors of over 1530 companies. A range of outcomes has been achieved by some of those companies, including companies restructuring, raising further finance and seeking professional advice from accountants or lawyers.
- 7 The majority of external administrations in Australia relate to small to medium proprietary limited companies. Statistics show that, in the majority of cases, minimal or no returns are being made to creditors. A key objective of the NITP was to encourage directors to seek professional advice at an early stage to maximise returns to creditors should the company go into external administration: see Appendix 1 for details of the ‘insolvency landscape’.
- 8 All directors should be aware that the Corporations Act imposes important duties on directors, such as the duty to prevent insolvent trading, general director duties and the requirement to keep adequate books and records: see Appendix 2 for details of directors’ ‘regulatory requirements’.

Objectives

- 9 The NITP aimed to:
- ensure that directors were aware of their director duties, and provide guidance to help them understand and comply with those duties (see Appendix 2 for a general outline of director duties);
 - ensure that directors took steps to remain properly and fully informed about the financial affairs of the company at all times;
 - make directors of potentially insolvent companies aware of their responsibilities and the implications of continued trading if they knew that their company was insolvent;
 - encouraged directors to seek professional advice from accountants and lawyers at an early stage, if they were aware of their company's financial difficulties;
 - encouraged directors to seek advice from an insolvency practitioner, where appropriate, and to take action to appoint an external administrator if necessary; and
 - protect the interests of external stakeholders, such as employees and creditors, by encouraging directors to seek advice at an early stage.

Review of companies at risk

- 10 A number of sources were used to identify and select companies for review, including, but not limited to:
- complaints received from the public, such as complaints from employees, unpaid creditors or other stakeholders;
 - credit agencies, such as Dun & Bradstreet and the ABR Credit Gazette;
 - auditor notifications under s311 of the Corporations Act relating to insolvency concerns;
 - financial accounts lodged with ASIC;
 - referrals from other stakeholder teams within ASIC; and
 - other sources (e.g. media, insolvency practitioners, credit managers, accountants, lawyers).
- 11 Companies selected for review varied in size from small, single-director companies with less than 20 employees to large proprietary companies with a high number of employees or companies listed on the Australian Securities Exchange (ASX).
- 12 The companies selected for review were not specific to particular industries, but were selected based on the sources identified at paragraph 10. Industries

reviewed under the program included, but were not limited to, retail, manufacturing, transport, childcare, hospitality, property, mining, clubs, financial services and agriculture.

- 13 A company was considered for surveillance based on a preliminary review of factors such as:
- the quality of the complaint or external source information;
 - the initial file review based on discussions with other ASIC teams or external sources;
 - preliminary tasks performed, including searches of the company's or directors' history of complaint activity or failed company activity; and
 - credit searches and financial analysis of publicly available financial accounts and announcements (if ASX listed).
- 14 If the preliminary review identified possible insolvency indicators, a surveillance was commenced by:
- contacting one of the company directors to arrange a suitable time to meet with them and their advisers, and the service of a notice under s30 of the *Australian Securities and Investments Commission Act 2001* to produce relevant records and financial information; and
 - attending a meeting, if possible—typically within 14 days of serving the notice—at which the directors were requested to provide an overview of the business and discuss the documents produced under the notice. At this meeting directors were encouraged to have their professional advisers (i.e. accountant and/or lawyer) attend to assist the directors with the process.
- 15 Following the meeting, ASIC officers would undertake a detailed review and analysis of the books and records produced in conjunction with the verbal information and explanations provided by the directors at the meeting.
- 16 If concerns or possible breaches of the Corporations Act were identified:
- a review letter was issued, setting out our concerns and requesting the directors to address those concerns. In most cases, this involved recommending that the directors seek appropriate accounting and/or legal advice to assist in the process;
 - in certain cases, where the company was insolvent or had significant indicators of insolvency, we may have requested that the director provide a written submission on solvency, which would include seeking the advice of an independent insolvency professional; and
 - on occasion, ASIC wound up a company where there were systemic solvency concerns and directors were failing to act appropriately. We considered this a last, but necessary, course of action to protect stakeholders.

- 17 If insufficient insolvency concerns were identified from the review, the director was notified and no further action was taken by us.
- 18 The purpose of providing a letter to the directors detailing the results of our review included:
- placing the directors on notice regarding their duties and obligations under the Corporations Act;
 - requesting further information from the directors to assist with the assessment of the company's financial position;
 - setting out our key insolvency indicators of concern;
 - requesting that the directors respond to our concerns about the company's solvency; and
 - requesting that the directors seek professional insolvency advice about the appointment of an external administrator.
- 19 Positive outcomes from our reviews were:
- an improved standard of financial information for the companies;
 - further finance or equity being injected into the companies to improve their financial position—whether by fundraising, accessing other sources of finance/refinancing or direct equity injections;
 - companies restructuring their businesses to streamline cost centres and improve cash flow and overall profitability; and
 - companies and their directors seeking professional advice to address solvency concerns.
- More detail on positive outcomes can be found at paragraph 27.
- 20 Where we identified significant insolvency indicators, the objective of the NITP was to encourage directors to seek advice from an insolvency professional about the appointment of an external administrator at an earlier stage than might otherwise have been achieved. Fifteen per cent of companies reviewed under the NITP resulted in the appointment of an external administrator.

Indicators of potential insolvency

- 21 The factors in Table 1 are examples of indicators of potential insolvency identified through the NITP (these indicators are not exhaustive or mutually exclusive).

Table 1: Indicators of potential insolvency identified through the NITP

Internal indicators	External indicators
<p>The company has a history of continuing trading losses.</p> <p>The company is experiencing cash flow difficulties.</p> <p>The company is experiencing difficulties in selling its stock, or collecting debts owed to it.</p> <p>Creditors are not being paid on agreed trading terms, and/or are placing the company on cash-on-delivery terms, before they will supply further goods and services.</p> <p>The company is not paying its Commonwealth and state taxes when due (e.g. PAYG, GST or superannuation guarantee contributions).</p> <p>Cheques are being returned dishonoured or the company is holding back cheques for payment or releasing post-dated cheques.</p> <p>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.</p> <p>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.</p> <p>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.</p>	<p>Legal action is threatened or has commenced against the company, or judgements are entered against the company, in relation to outstanding debts.</p> <p>The company has reached the limits of its funding facilities and is unable to obtain appropriate further finance to fund operations.</p> <p>The company auditor has qualified their audit opinion on the grounds that there is uncertainty about whether the company can continue as a going concern.</p>

- 22 If a company is experiencing any of the above indicators of insolvency, a director should seek immediate professional advice to address the solvency issues, or maximise the likelihood of a return to creditors should the company enter into external administration.

B Outcomes of the national insolvent trading program

Key points

The NITP specifically increased the education and awareness of directors of their duties as a result of meeting with ASIC. Also, professional advisers, such as lawyers and accountants, who have been involved in meetings with us, received an understanding of the NITP and indirectly transferred this knowledge to their director client base.

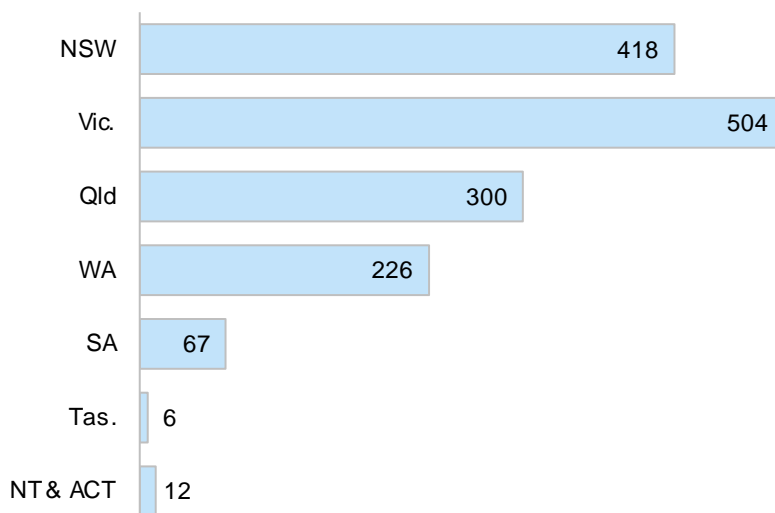
Positive results achieved under the program provided a better outcome for company stakeholders, as shown in the statistics below.

The NITP resulted in 15% of companies reviewed being placed into external administration—mostly by the directors. We consider the appointments were likely to have occurred at an earlier stage as a consequence of our review under the program.

Overview

23 The NITP was a national program focusing on companies that may have been experiencing signs of financial distress. During the period from 2005–06 to 2009–10, we visited 1533 companies.

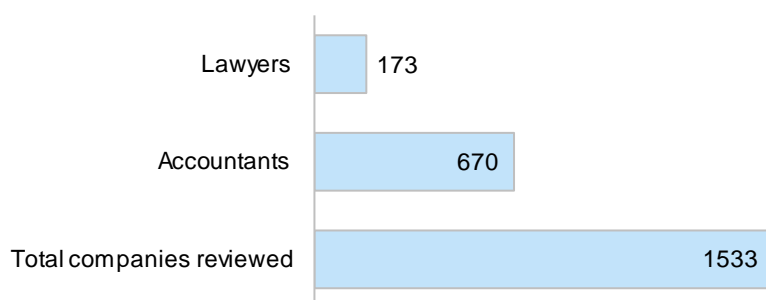
Figure 1: Number of companies visited under the program by location



Professional advisers

- 24 At the meetings held with directors, where they were requested to provide ASIC with an overview of the business and discuss the documents produced under the notice, directors were encouraged to have their professional adviser(s) attend where possible. This generally included the company's external accountant and/or external lawyer. A summary of the number of professional advisers involved in the NITP is provided in Figure 2.

Figure 2: Number of professional advisers in attendance at meetings held



- 25 The NITP also provided an awareness of director duties and our expectations of these professional advisers when companies were experiencing financial difficulties. These professional advisers may subsequently have transferred the education gained from the NITP to other clients (i.e. directors), creating a general positive change in the broader behaviour of directors.
- 26 We consider this education and engagement with a greater number of external professional advisers to have been a broader regulatory outcome of the NITP.

Positive outcomes

- 27 We consider that the NITP facilitated positive outcomes as a consequence of directors seeking professional advice and/or taking steps to improve the financial performance and position of the company.
- 28 Positive outcomes achieved by the NITP include the following.

Improved financial information

ASIC identified when a company's books and records were deficient and, accordingly, the director was not in a position to accurately determine the company's financial position. As a result, we requested the director to arrange for up-to-date financial accounts to be prepared, or to implement other measures to bring accounts up to date following our review. We consider that, as a result of the review, directors were in a better position to make informed decisions about the company's financial position.

Fundraising

ASIC identified insolvency concerns—specifically, cash flow difficulties. Following our review, directors obtained additional finance by conducting a fundraising exercise. The fundraising could have taken the form of a capital raising by an ASX-listed company, or obtaining a bank loan or an equity injection by a director for a proprietary limited company. The amount raised by the company had to be sufficient to alleviate our insolvency concerns.

Refinancing

ASIC identified insolvency concerns, including cash flow difficulties and/or inadequate financing arrangements given available assets. Following our review, directors refinanced certain loans or banking facilities to obtain additional working capital. The amount raised by the refinancing had to be sufficient to alleviate our insolvency concerns and protect the interests of external stakeholders (i.e. creditors and employees).

Restructuring

Following concerns raised by ASIC, directors sought professional advice to restructure financial and/or operational areas of their business. The restructure may have included the cessation of unprofitable arms of the business, the implementation of a streamlined costing analysis, entering into a payment arrangement with the Australian Taxation Office (ATO) for unpaid taxes, or subordinating director and/or related party debts to unsecured creditors.

Seeking professional advice

ASIC recommended directors seek professional advice if insolvency indicators were identified following our review and were of concern to us. As a result of our requests, the directors sought professional advice, which provided a better outcome for external stakeholders (e.g. by seeking an accurate financial position, a successful restructure or refinancing, or identifying the requirement to appoint an external administrator, sooner rather than later and avoiding insolvent trading and additional stakeholder losses).

Details of the outcomes of seeking insolvency advice under the NITP are discussed in paragraphs 33–35.

- 29 The positive outcomes achieved under the NITP also resulted in ensuring directors acted in accordance with their director duties imposed under the Corporations Act. For example, directors refinancing or restructuring their companies acted with care and diligence, and in good faith in the best interests of the company.
- 30 We are not aware of any known negative impacts of the NITP. The most common concern by directors was the volume of material required to be produced to ASIC. In most instances this information should have been

readily available. When these records were not available, this often highlighted an internal reporting or accounting deficiency within the company.

31 Following are some specific examples of the positive outcomes that the NITP achieved.

Example 1

A positive outcome under the NITP was achieved by a company that manufactures supplies for large mining clients nationally. The company was identified as a result of a series of legal actions by unpaid creditors. ASIC's review identified significant insolvency indicators, including cash flow difficulties, working capital deficiencies, aged creditors and a large number of held cheques.

As a result of our review, the director sought professional advice from an external accountant who assisted him with restructuring the company to purchase all of the company's shares and sell off surplus non-core assets. The director also raised substantial finance to inject into the company for working capital and subordinated this loan to all unsecured creditors.

The restructure and refinance resulted in the company paying its aged creditors in full and releasing a substantial amount of held cheques. The working capital position improved significantly due to the reduced trade creditors and the subordination of the loan, resulting in a positive outcome for creditors.

Example 2

Professional advice was sought by a large boat manufacturer, which resulted in a positive outcome for stakeholders. Insolvency indicators included significant trading losses over an extended period of time, working capital and net asset deficiencies, unpaid ATO liabilities, aged trade creditors and undocumented related party loans.

ASIC requested the director seek insolvency advice on the company's solvency concerns. The director engaged an external accountant to assist with an assessment of the cash flow requirements of the business and insolvency advice was obtained.

As a result of the advice received from professional advisers, the company:

- engaged a procurement expert to reduce costs;
- reduced production to a profitable level;
- reduced employee numbers;
- paid the ATO in full and brought lodgements up to date; and
- subordinated significant related party loans.

The director acted in the best interests of the company and its stakeholders by engaging in the above actions and avoided the appointment of an external administrator at the time, which resulted in a positive outcome.

Insolvency advice sought

- 32 Where ASIC identified significant insolvency indicators, the objective of the NITP was to encourage directors to seek advice from an insolvency professional about the appointment of an external administrator.
- 33 As noted in paragraph 54 of Appendix 1, statistics show that 97% of external administrations result in estimated dividends of less than 10 cents in the dollar to unsecured creditors. Under the NITP, ASIC identified significant insolvency concerns and requested that directors seek the appointment of an external administrator at an earlier stage than they were likely to have done if we had not intervened.
- 34 Further, the NITP educated directors about the duty to prevent insolvent trading imposed under s588G. Where significant insolvency concerns were identified, and directors were made aware of s588G, directors generally acted in the best interests of the company and sought professional insolvency advice, which may have resulted in the appointment of an external administrator. Examples of directors seeking professional insolvency advice and acting in the best interests of the company are below.

Example 3

A yachting club was the subject of review by ASIC as a result of a series of complaints received from the public. Our review identified significant indicators of insolvency, which were relayed to the directors together with a request to seek immediate advice from an insolvency professional.

After receiving the letter from us, the directors attempted to obtain additional finance for working capital to mitigate ASIC's solvency concerns. When the company was unable to obtain additional finance, the directors sought insolvency advice and voluntary administrators were appointed to the company.

The directors noted that the board had taken on our concerns, and the reminder of director duties, which led them to make the appointment of the voluntary administrators when no alternatives remained.

The company entered into a deed of company arrangement resulting in priority creditors receiving a dividend of 100 cents in the dollar and unsecured creditors receiving a dividend of 47 cents in the dollar.

Example 4

A publicly listed company was reviewed under the NITP and found by ASIC to have serious indicators of insolvency. These indicators included deficient books and records, significant trading losses, a severe working capital deficiency and aged creditors in excess of \$3 million.

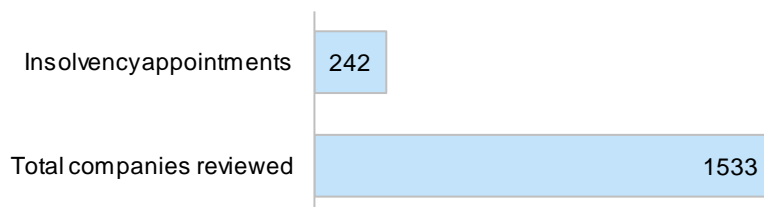
We suggested that the directors seek immediate advice from an insolvency professional on the company's solvency position. The directors appointed an insolvency firm to prepare a solvency review of the company. The solvency review found that the company was insolvent and recommended the immediate appointment of voluntary administrators to the company.

The directors immediately appointed voluntary administrators to the company, resulting in the timely appointment of an external administrator to the publicly listed company.

The company entered into liquidation, resulting in priority creditors receiving a dividend of 100 cents in the dollar and unsecured creditors receiving a dividend of 40 cents in the dollar.

- 35 Figure 3 shows that approximately 15% of companies reviewed under the NITP resulted in the appointment of an external administrator. In all of these cases the insolvency indicators were substantial and resulted in most of the companies being placed into external administration by the directors.

Figure 3: Number of insolvency appointments relative to total companies reviewed



ASIC action

- 36 As noted in paragraph 16, ASIC on occasion wound up companies where appropriate. This course of action was taken by us in extreme circumstances where we identified significant insolvency concerns and the directors did not take action to either address the concerns or appoint an external administrator to the company. ASIC took this action to protect the stakeholders of the company. Examples of ASIC winding up companies to protect the interests of their stakeholders are below.

Example 5

The Supreme Court of Queensland ordered the winding-up of Brisbane-based property developers Neolido Holdings Pty Ltd and Neo Lido Pty Ltd. ASIC commenced proceedings seeking orders for the appointment of a provisional liquidator as well as final orders to wind up the two companies, following solvency concerns identified under the NITP. As the solvency concerns were significant, ASIC took such action to protect the interest of the company's stakeholders.

The Supreme Court of Queensland ordered the winding-up of Neovest Ltd on the grounds of insolvency, and on just and equitable grounds, following an application by us. Neovest was linked to Neolido Holdings Pty Ltd and Neo Lido Pty Ltd.

Neovest Ltd was owed significant funds by Neolido Holdings Pty Ltd and Neo Lido Pty Ltd and continued to raise capital from the public after these related companies were ordered to be wound up. ASIC alleged Neovest was operating while insolvent.

Example 6

The Federal Court in Brisbane ordered an ASX-listed company, Green Pacific Energy Limited (GPE), and its subsidiary, Green Pacific Energy Capital Pty Ltd, to be wound up following an application made by ASIC.

We sought to wind up Sydney-based GPE on the grounds of insolvency, and on just and equitable grounds, based on the following main events:

- the use of \$4.8 million, out of \$6.3 million invested in GPE, for the repayment of debts owed by a director in their capacity as Chairman and Chief Executive Officer. This was done without the knowledge or approval of the GPE board of directors, and contrary to the direct representations that were made to investors and the public via ASX announcements; and
- the promotion of promissory notes in GPE at public seminars and the issue of those promissory notes to members of the public, under the direction of the director, to raise capital for the company when the board of directors had not clearly resolved to issue the promissory notes.

The Honourable Justice Greenwood was satisfied that the conduct of the director was improper and misleading.

- 37 In certain instances, ASIC referred relevant information about a company's financial position to another regulatory agency (e.g. the ATO or the Department of Consumer and Employment Protection) under a memorandum of understanding with that agency. The regulatory agency was then able to act on the specific information received from ASIC—information it may otherwise have been unable to obtain.
- 38 An example of this includes informing the ATO when a superannuation guarantee charge was owed to employees and was not remitted by the company to the ATO. The ATO was then able to take action to have the outstanding employee entitlements recovered from the company, protecting the interests of those employees.

C Key messages for directors

Key points

The NITP identified several areas where there continues to be room for improvement by directors. There are four key messages from the program that directors should take into account in carrying out their role:

- maintaining appropriate books and records;
- identifying insolvency concerns and assessing available options;
- seeking professional advice; and
- acting in a timely manner.

Where a director follows these key messages, they are less likely to breach their duties under the Corporations Act.

Message 1: Maintain appropriate books and records

- 39 A director must ensure that proper books and records are kept by the company and take reasonable steps to keep themselves properly and fully informed about the financial affairs of the company at all times so that they can reasonably form a view about:
- the company's present financial viability; and
 - the impact of incurring any further debts.
- 40 Some of the activities a director may need to undertake to ensure that they are sufficiently informed about the company's position may include:
- involving themselves in and/or overseeing the preparation of profit and cash flow budgets, regular management accounts and monitoring actual results against budget expectations;
 - reviewing the company's ability to collect debts owed to it and to realise other current assets including stock on a regular basis;
 - monitoring when creditors are due to be paid and the company's ability to comply with normal terms of trade; and
 - reviewing the current level of bank lending facilities and the ability to access additional funding if required.
- 41 Maintaining appropriate books and records in accordance with the recommendations above will ensure directors are informed about the company's financial position and are in a better position to act in the best interests of the company and its creditors if the company experiences insolvency concerns.

Message 2: Identify insolvency concerns—assess available options

- 42 Directors must act in accordance with the general director duties imposed by the Corporations Act and in the best interests of the company and its stakeholders (including employees and creditors).
- 43 As soon as there are reasonable grounds to suspect that the company is in financial difficulty, or that the company is insolvent, directors should:
- take positive steps to confirm the company’s financial position and realistically assess the options available to deal with the company’s financial difficulties; and
 - carefully consider the company’s solvency before the company incurs each new debt.
- 44 Options available to address the company’s solvency concerns include, but are not limited to, the following:
- seeking accurate and up-to-date financial information to address available options;
 - restructuring the company’s operations and financial affairs;
 - obtaining additional finance under current finance arrangements;
 - seeking new funds via fundraising efforts;
 - seeking formal repayment plans with creditors, including the ATO; and
 - subordinating related party loans to the company’s unsecured creditors.

Message 3: Seek professional advice

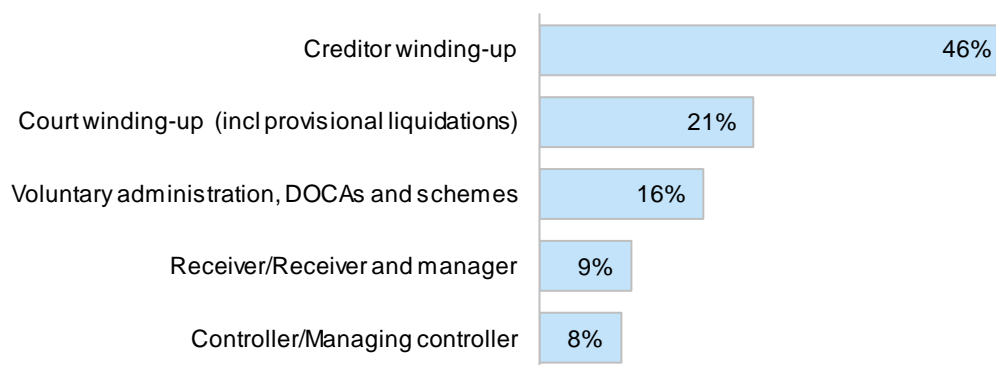
- 45 As soon as there are reasonable grounds to suspect that their company is in financial difficulty, a director should obtain appropriate advice from a suitably qualified, competent and reliable person about the financial position of the company and how the financial difficulties can be addressed. ASIC expects directors to seek independent insolvency advice where there are significant indicators of insolvency.
- 46 Directors should consider seeking advice on:
- the solvency of the company and whether there is a risk that the company is trading while insolvent;
 - the options available to the company to deal with its financial difficulties, including those addressed in paragraph 44;
 - whether it is realistically possible to continue to trade the company’s business; and
 - whether they should place the company into external administration.

Message 4: Act in a timely manner

- 47 Directors must consider any professional advice sought on the company's financial position and take appropriate action in a timely manner.
- 48 Where there are reasonable grounds to suspect that the company is insolvent, the directors must take steps not to incur further debts and should obtain and consider advice about the options available to them to deal with the company's financial difficulties.
- 49 Where there are reasonable grounds to expect that the company cannot pay its debts as they fall due, based on the advice the directors receive, the directors should consider the immediate appointment of an external administrator to the company.
- 50 If, based on advice, the directors implement a restructuring plan, the directors should continue to monitor trading to ensure the company's ability to meet its debts as they fall due does not deteriorate.
- 51 Acting on advice received from an insolvency professional in a timely manner is integral to the director's duty to prevent insolvent trading and to act in the best interests of company stakeholders.

Appendix 1: Insolvency landscape

- 52 A company is insolvent if it is unable to pay its debts as and when they fall due. There are three principal corporate insolvency procedures which apply when a company is, or is likely to become, insolvent. These include:
- Voluntary administration—a voluntary administrator is usually appointed by a company’s directors after they decide that the company is insolvent or is likely to become insolvent.
 - The objective of the voluntary administration is to maximise the chances of a company, or as much as possible of its business, continuing in existence or, if that is not possible, to provide a better return to creditors than would result from an immediate winding-up.
 - The role of the voluntary administrator is to investigate the company’s affairs, report to creditors on the company’s financial position and recommend whether the company should enter into a deed of company arrangement (DOCA), go into liquidation or be returned to the directors.
 - Liquidation—this is an orderly winding-up of a company’s affairs. It involves the cessation or sale of its operations, realisation of the company’s assets and distribution of any proceeds among creditors. There are two types of liquidation:
 - creditors voluntary liquidation—this results from a resolution of creditors and shareholders (generally being the director), or creditors in a voluntary administration resolving to place the company into liquidation; and
 - court liquidation—this starts as the result of a court order, made after an application to the court, usually by a creditor.
 - Receivership—most commonly, a company enters into receivership when a receiver is appointed by a secured creditor which holds security over some or all of the company’s assets. A receiver’s role is primarily to collect and sell a sufficient quantity of the charged assets to repay the debt owed to the secured creditor.
- 53 Figure 4 shows that the greatest number of external administration (first-time) appointments are generally director driven through creditor voluntary windings-up (46%) and voluntary administrations (16%). Creditor-driven appointments through court liquidations amount to 21% and secured creditor appointments to 9%.

Figure 4: Total external administration appointments—July 2009 to June 2010

54 While the chart shows the greatest number of external administrations are director driven (creditor voluntary windings-up and voluntary administrations together amount to 62% of the total), the statistics in paragraph 55 demonstrate that the return to creditors in the majority of external administrations is minimal.

55 Based on the statistical data collected from statutory reports lodged with ASIC by insolvency practitioners, most external administrations relate to small to medium proprietary limited companies. Estimates provided by practitioners in statutory reports lodged in the 2009–10 financial year disclose:

- 75% of companies had less than 20 employees;
- 86% had less than \$100,000 in assets;
- 80% had unsecured creditors owed \$500,000 or less;
- 70% had no secured creditor; and
- estimated dividends of less than 10 cents in the dollar to unsecured creditors were likely in 97% of external administrations.

56 A key objective of the NITP was to encourage directors to seek professional advice at an earlier stage to address the solvency issues, or increase the likelihood of a return to creditors should the company enter into external administration.

Appendix 2: Regulatory requirements

- 57 Within the insolvency context, the Corporations Act imposes duties on directors relating to general director duties and the duty to prevent insolvent trading.
- 58 Director duties imposed by the Corporations Act include:
- s180—the duty to exercise your powers and duties with the care and diligence that a reasonable person would have, which includes taking steps to ensure you are properly informed about the financial position of the company and ensuring the company doesn't trade if it is insolvent;
 - s181—the duty to exercise your powers and duties in good faith in the best interests of the company and for a proper purpose;
 - s182—the duty not to improperly use your position to gain an advantage for yourself or someone else, or to cause detriment to the company; and
 - s183—the duty not to improperly use information obtained through your position to gain an advantage for yourself or someone else, or to cause detriment to the company.
- 59 Section 286 provides that a company must maintain written financial records that correctly record and explain transactions and the company's financial position and performance. A director has a positive duty under s344 to ensure that a company complies with s286.
- 60 A director must be fully informed about the financial affairs of the company at all times, so that they can reasonably form a view about:
- the company's present financial viability; and
 - the impact of incurring any further debts.
- 61 A director has a positive duty to prevent insolvent trading under s588G. Section 588G requires a director of a company to prevent the company from incurring a debt if:
- the company is *already* insolvent at the time the debt is incurred; or
 - by incurring that debt, or by incurring a range of debts including that particular debt, the company becomes insolvent,
- and, at the time of incurring the debt, there are reasonable grounds for suspecting that the company is already insolvent, or would become insolvent by incurring the debt. Generally, a company is insolvent if it is unable to pay all its debts when they fall due.

62 A director is less likely to breach their duty to prevent insolvent trading when they take into account the following key principles in carrying out their role:

- keeping themselves informed about the financial affairs of a company, and regularly assessing the company's solvency position;
- on identifying concerns about the company's viability, seeking to confirm the financial position and assess options to deal with the company's financial difficulties; and
- obtaining appropriate professional advice and considering and acting appropriately on the advice received.

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that act
creditor	A person who is owed money
director	A natural person appointed as a director of a company who is then responsible for directing and managing the affairs of a company, or a shadow director
employee	A person engaged by a company under an award, certified agreement or contract of employment and paid wages, salary or commission
external administrator	A person formally appointed to a company or its property. This includes a provisional liquidator, liquidator, voluntary administrator, deed administrator, controller, managing controller, receiver, receiver and manager, and scheme administrator
insolvent	Unable to pay all debts when they fall due for payment
NITP	National insolvent trading program
s311 (for example)	A section of the Corporations Act (in this example, numbered 311), unless otherwise specified