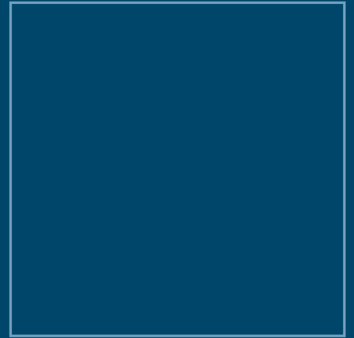

keeping afloat – the corporate challenge

Contents

Introduction	3
Monitoring Progress	5
Warning Signs	8
Rescue Procedures	15
Implications of Insolvency for a company's directors	20
Plan ahead, take advice	22

ABOUT ACCA

ACCA is the largest and fastest-growing international accounting body, with over 300,000 students and members in 160 countries. ACCA has an extensive network of 70 staffed offices and other centres around the world.

ACCA's mission is to provide quality professional opportunities to people of ability and application, to be a leader in the development of the global accountancy profession, to promote the highest ethical and governance standards and to work in the public interest.

Introduction

For some years, the UK has had in place an advanced set of legal procedures which enable companies and individuals in financial trouble to reach agreement with their creditors and thus stave off outright insolvency, with all the implications which that can have for investors, staff and creditors. Under changes to the law which have come into effect in 2003 and 2004, several of these procedures are streamlined and updated with a view to making them easier to use and, at the same time, more generous to trade creditors.

These changes have been brought in at a time when the upwards trend in UK business failures, which started in the late 1990s, appears to be slowing. Between 1997 and 2002, insolvent company liquidations rose from under 13,000 a year to over 17,000, but the total for 2003 fell by over 10% to under 15,000. The number of personal insolvencies, however, showed a substantial increase.

A statistical snapshot like this may be a useful indication of the overall health or otherwise of the economy. If more firms are surviving, that must mean that more trade is going on and that more suppliers are being paid and then using that income to fund their own businesses and to pay themselves and their employees.

What statistics will not show, though, is that the survival or failure of an individual business is not exclusively dependent on the prevailing state of the economy: there will always be companies which thrive while others struggle, regardless of the overall business conditions in which everybody operates. 40% of companies on the register at Companies House have been incorporated for three years or less; around 200,000 are removed from the register every year.

Running a successful business requires the vision and drive to identify a market opportunity and then satisfy the demand created. But it also requires the ability to manage the firm's finances prudently and to adapt to changing circumstances. Studies have suggested that business efficiency, particularly in the small company sector, often suffers because of the inability of proprietors, for whatever reason, to deal properly with a problem until it reaches crisis proportions. Some business people may see wrestling with problems as they arise as being part and parcel of the challenge of being in business in the fist place. But making reasonable preparations for dealing with foreseeable eventualities should be seen as a fundamental element of good financial management. Where company directors are concerned, this function takes on the added character of a legal responsibility.

Helping small businesses to manage their finances, to install proper credit control procedures, to plan for the future and guard against threats is where experienced practising accountants can offer valuable support. This booklet serves as an introduction to these services and provides some useful tips to directors in connection with the basic objective of keeping their companies afloat. It also addresses the corporate rescue options which are available under the law for use by companies in financial trouble. The booklet focuses mainly on companies but much of the advice on financial management applies equally to other forms of business enterprise.

Monitoring progress

All those involved in the running of a business have an obvious personal interest in ensuring that their firms remain commercially viable. Sole traders and partners in partnerships are, ultimately, responsible for the debts of their businesses. If their businesses become insolvent, it is they who may be looked to to reimburse creditors who have lost money. This fact will serve to concentrate the minds of the individuals concerned on the importance of keeping a careful check on the on-going financial health of their business.

Directors of limited companies (and members of limited liability partnerships), have numerous legal obligations to fulfil by virtue of their positions. Where they fall short of meeting those obligations, they may be subjected to criminal and civil proceedings which can involve the imposition of financial penalties and even personal liability for their firms' debts.

Company law, in fact, lays down specific requirements for directors to monitor routinely the financial performance and position of their companies. The Companies Act places a duty on all directors to keep accounting records which are sufficient to produce a 'reasonably accurate' picture of the company's financial position 'at any time'. It follows that all directors who are complying with their legal duty as regards record-keeping should be capable of making a reasonable assessment of the state of their company's financial health at any time. Regardless of specific legal requirements to monitor a business's financial position regularly, doing this is important for practical purposes at all stages of its existence, in order for directors to be able to manage the firm's activities properly and for them to make any adjustments or to take any action which might be appropriate in the circumstances.

Monitoring a company's financial performance will be an especially vital function for directors to undertake when their company is in financial difficulties. While, in normal circumstances, the directors of a company are required by the law to act in the interests of their company's shareholders, when a company becomes insolvent the law expects them to act in the interests of their company's creditors.

The Insolvency Act 1986 expresses this principle in the provisions which govern so-called 'wrongful trading'. Where a company goes into insolvent liquidation – i.e. where it goes into liquidation at a time when its assets are insufficient to pay its debts and liabilities as well as the costs of the winding up - the company's liquidator will investigate the trading history of the company and the actions of the individual directors in order to decide whether the company continued trading for too long before taking some form of remedial action in the interests of its creditors. If the liquidator can identify a point in time at which its directors (or any 'shadow director' it might have) either knew that their company could not avoid insolvent liquidation or should have

known that it could not have avoided that fate, then he may apply to the court for an order to be made requiring them to compensate creditors for the unpaid debts run up by the company after that critical point was reached. Thus, the general rule that company directors are not personally responsible for their company's debts can be overturned.

The fact that the law can rule retrospectively on what conclusions should have been reached by directors as to the financial prospects of their company highlights the importance for them of keeping a regular check on its position. It may not be good enough for directors to plead, in defending any wrongful trading action, that the reason they were not aware of the seriousness of their company's position was that impending failure had not been signposted by the figures shown in its last annual accounts. This retrospective element should also serve to emphasise to directors that they need to be aware of the implications of wrongful trading ***before*** their company goes under, not after. They need also to be aware of the options which are available to them if they are to save their company and avoid incurring personal liability.

The wrongful trading provisions, being retrospective in their application, pose special difficulties for directors who recognise that their company is - at a particular point in time - technically insolvent but whose instincts and knowledge of their business convince them that the company can survive and return to health. If a company can trade its way out of trouble, no liability under the wrongful trading rules will ensue, but directors in that position should be aware of the possible consequences of not acting responsibly and in the interests of creditors once their company becomes technically insolvent.

Although wrongful trading actions rarely reach the courts, successful cases have been brought, and directors should not underestimate the potential effect of this area of the law.

A solicitor or a specialist insolvency practitioner will be able to offer advice to directors on the steps which they should take, should they feel in an exposed situation, to protect the interests of creditors and thereby minimise the risk of attracting a wrongful trading liability.

Warning signs

In order to prosper, organisations of all kinds need to ensure that they are alert both to opportunities for achieving success and threats to their survival. If a business is unable to take advantage of commercial opportunities, then it will not be in any position to profit from them for the benefit of itself, its shareholders and employees. And if a business cannot identify and react to threats to its financial health, it risks becoming insolvent, with detrimental consequences for its shareholders, employees and creditors.

Any business can be laid low by a catastrophic event which happens without warning, such as a massive liability claim which its insurance policy cannot cover or some unrelated event over which it has no control and which causes bad publicity - and loss of market - for the products or services which it provides.

In the normal course of events, however, businesses can and should be capable of monitoring the progress of their business performance, in particular its cash flow, and taking prompt action to identify and resolve problems which threaten their financial well-being. In a nutshell, they must be ready and able to defend themselves against predictable dangers. Doing this involves the business putting itself in a position from where it is able to recognise threats and take whatever pre-emptive action may be necessary to extinguish, or at least limit, the dangers posed.

Regardless of any requirements which may be laid down in law for the managers of a business to monitor its financial position on a regular basis, it is sound business practice for them to maintain a regular check on the company's ability to meet its commitments. They should do this by reviewing management information and profit/cash flow projections on a regular basis. As part of this process of regular review, managers should look out for certain warning signs and take steps immediately to address both the problem itself and its underlying cause(s). The following is a list of major problem indicators.

Inadequate credit control

Credit control is about making sure that your customers and clients pay you for the goods or services that you provide to them. Whenever a business delivers goods or services without being paid up front, there is an element of risk that it will not get paid, or at least that it will have to devote time and effort, and perhaps go to court, in order to receive the money due to it.

If you are not receiving the money for the work that you have carried out, then your business may well have to borrow money, and pay interest on it, to make up for the shortfall. If you are regularly failing to receive the money you are owed, your cash flow may suffer serious damage.

Warning signs

The ideal solution is, of course, to ensure that you are paid in advance each time you provide goods or services. This, unfortunately, is not a realistic proposition for the vast majority of businesses. Any business can, however, take reasonable steps to minimise the risk of not being paid. This should involve

- ***Running credit checks on new customers.*** If you do not consider it to be economic to do this with respect to each and every new customer, then perhaps credit checks could be carried out wherever the credit asked for exceeds a threshold which you consider to be a material risk.

- ***Being clear about your payment terms.*** Make sure that you issue invoices on delivery of goods and services, in which you make clear by when you expect payment to be made and what, if any, penalty clauses you intend to apply in the case of non- or late payment. You may wish to include in this a statement that you intend to charge statutory interest in accordance with the Late Payment of Commercial Debts (Interest) Act 1998 if payments are not received by the due date. (Under the Act, businesses have the legal right to charge a set level of interest if payment is not made either by the contractually set date or, where there is no such date, within 30 days).

- ***Keeping in regular contact with your customers and clients.*** This will help to maintain a good working relationship and, possibly, enable you to detect in advance any problems that they might be having in paying your bills.

Substantial increases in overheads

Like repayments of commercial debt, overheads are regular payments which you are obliged to pay regardless of whether or not you have sufficient cash to meet them. Businesses will sometimes think fit to make a conscious decision to increase their overheads – including rent payments, maintenance expenses and staff wages - in the expectation that the extra investment will help them to increase turnover. In some cases, though, a business will find its overheads escalating for reasons beyond its control, e.g. where wage rates are forced up or the cost of lighting and heating increases significantly. If the increased expenditure on overheads does not lead to an increase in turnover which more than offsets the higher overheads, then the business will have problems which it will need to resolve. But the business will only be in a position to take such remedial action if it keeps a close watch on how its overall financial performance has changed (if at all) following the increase in overheads.

Warning signs

Indications of impending material bad debts
Most businesses, at some time or other, will experience 'bad debts', i.e. debts which will not be paid due to the insolvency or disappearance of a customer or client. These will probably have to be written off against your profits. The more you depend on a particular customer or client, the more likely it is that one bad debt – or a series of them – will cause you major problems. For this reason you should be cautious about becoming too dependent on a single client or customer or a small group of them. Whether or not a business is over-dependent, bad debts can cause serious damage. You should therefore try to be alert to information concerning the financial health of your customers and clients. If you become aware that a material debt is not likely to be paid, you should as soon as possible consider what options are open to you to help you mitigate the adverse effects of the non-payment.

Declining stock turnover ratios
Most businesses wish to sell their stocks as soon as they can. If they have to be kept for too long, not only will the business have to pay the cost of their maintenance but the stocks may prove increasingly difficult to sell, and their value may have to be discounted. So a business needs to keep under close review how long different products are taking to sell. This information will enable managers to make appropriate policy decisions, e.g. to discontinue certain product lines or to review sales and marketing techniques.

Any failure of the company to comply with its loan covenants
When borrowing money from a bank or other lending institution, a business will invariably agree to comply with set terms for the repayment of the principal debt together with any associated interest. The loan agreement will explain the implications of any failure to comply with these undertakings, which may well include a right for the lender to initiate specified legal or recovery action against the borrower. Clearly, this will be a serious situation for any borrower. Accordingly, a business should strive to ensure that its cash flow is managed so as to enable it to meet its regular repayment obligations as they fall due. If it finds that it cannot meet individual payments it should contact the lender and investigate the reasons for its inability pay, with a view to ensuring that subsequent payments are not similarly affected.

A recent history of qualified audit reports in the accounts of a major supplier or customer
A qualified audit report will indicate that the auditors of a company's accounts have not been able to satisfy themselves that the financial information in those accounts allows them to give the company a 'clean bill of health'. The reason for the qualification will be given in the report. It may be because the accounts do not give an accurate picture of the company's recent trading or financial position, or because the auditors were not able to verify the figures in the accounts, or

because the accounts do not suggest that the company is still a 'going concern', or in other words likely to continue as a profitable business. You should be prepared to investigate the cause of any qualification in the audit report.

An excessive reliance on loan finance

Most businesses, whatever their size, find that they need to borrow funds to finance their growth or working capital. The attraction of loan finance is that the ownership structure of the business is not diluted by the borrowing. On the other hand, borrowing brings with it continuing obligations for the business to repay capital and associated interest charges on an agreed timetable. Any commitment of this kind places strains on a company's cash flow position, particularly if loan agreements include the right of a lender to vary the rate of interest being charged. It follows that the higher the proportion of a company's capital which is taken up by debt, the greater the strain that is placed on a company's ability to generate the cash that is needed to cover the repayment obligations, and the greater the threat that a sudden interruption in income can lead to serious default. If a business is confident about its ability to raise regular income, then a high 'gearing' ratio may be supportable, but in most cases businesses should be wary about over-stretching themselves.

Evidence that the company is 'overtrading', meaning that the company's capital base is insufficient for it to sustain the level of turnover being sought

Over-trading involves a business taking on more commitments than, in reality, it is able to cope with. While rapid growth sounds an ideal situation for any business, it can sometimes prove to be dangerously counter-productive. Businesses need always to satisfy themselves that they have the capacity to actually provide the products or services which they try to sell to customers and clients. If they try to sell more than they can deliver, they may be tempted to invest heavily in the premises, machinery and staff to enable them to produce the desired quantity of products or services. This sort of investment will increase the company's overheads and/or debt obligations. If, subsequently, the company's sales do not perform as well as expected, it may not have the cash inflows which enable it to meet the commitments which it has taken on.

Excessive reliance on one customer or a small client base

If a business has just one regular customer or client, or a small number of them, it will be at greater risk of being damaged by factors beyond its control than if it has a wide client base. If, for example, there is a serious disagreement between the business and its single customer which results in

Warning signs

the customer withdrawing its orders, or if the sole customer becomes insolvent, then the whole future of the business will be put into doubt. If at all possible, a small business should reduce its exposure to the risk of this happening by seeking to cultivate a wider client base.

Bank errors
A business, like an individual, can fall victim to mistakes and errors made by its bank. A business should check its bank account balances regularly - this can now be done speedily via the internet - and reconcile its cash records with the figures appearing in its bank account.

Declining liquidity, with the associated implications for the company's ability to pay its creditors as their debts fall due
Liquidity is the ability of a business to find the cash with which to pay its short-term debts. It is no good for a business if it has substantial funds tied up in long-term investments if it has no assets which can be converted readily into cash at short notice in order to pay debts of all kinds. The consequence of not being able to find the cash to pay those debts as they fall due may be that the company is subjected to legal action by unpaid creditors to recover their money. At its most serious, action by a company's creditors can threaten its existence. The amount of funds which a business should keep in 'liquid' form, i.e. in a form which is quickly convertible into cash, will depend on the frequency and size of its debt commitments. But any signs that the company's financial management policies do not provide the business with enough ready cash to pay its bills should be addressed.

Any evidence that assumptions and forecasts used in making past investment decisions have proved significantly unreliable.
When preparing income and expenditure forecasts, and assessing the likely profitability of investment projects, a business will make certain assumptions and estimates about the future. Planning is not an exact science and a degree of subjective judgement will almost always play a part in this process. But forecasts and assumptions are nonetheless highly important since they may be used by the business as a basis for decisions on major capital expenditure. A business should always review whether or not they have proved to be justified with the benefit of hindsight. This should be done at the end of each planning period. If it turns out that past assumptions and forecasts have proved inaccurate, the business should consider the reasons why and try to learn lessons for the future.

Warning signs

The presence in the accounts of a high level of contingent liabilities

A contingent liability is a financial obligation which derives from past events and which a business may have to meet if certain events occur in the future. It is, therefore, a debt which the business has no actual responsibility for at present, but which it should prepare for in the light of the (known) events which would trigger the actual liability.

The existence of any contingent liabilities adds a degree of uncertainty to a company's finances – the company recognises that it may have to incur this expenditure but its responsibility to do this cannot be established with certainty. Where it has a contingent liability which is material in the light of its own financial circumstances, or a number of them which together amount to a material liability, the element of uncertainty is increased, meaning that the company's financial future may be dependent on issues beyond its control. Such liabilities should be faced up to and not ignored, and provision must be made for the possibility that the company will be called upon to meet the obligations concerned.

The directors or managers of any business should, therefore, aim to monitor its finances on an on-going basis and be alert to matters which might have an impact on its viability. They should aim to do this by reviewing management information and profit/cash flow projections as regularly as is appropriate in the light of the needs of the business.

Businesses will differ on the degree of sophistication required in their accounting systems, and on the nature and the level of detail of the management information they will want to draw from it. In designing and implementing a management information system, the essential prerequisite must be to determine just what the company's information needs are, bearing in mind its size and structural complexity, the nature of its business and its cash commitments. In all cases, however, the system should be capable of alerting a company's management to real or potential financial problems and thereby enable it to plan remedial action in good time.

If you need help with keeping your accounting records in shape, or with preparing periodical management accounts and forecasts to use as a basis for the sound financial management of your company, your accountant will be able to help.

Rescue procedures

If, from the monitoring of its own financial affairs, a company fears that either it is insolvent already or is in serious danger of becoming so, it will need to consider what remedial action, if any, is feasible in the circumstances.

To redress any capital or liquidity shortfall a company will wish initially to consider the possibility of being able to attract new finance, either in the form of new equity capital or grants or loans. The difficulties experienced by businesses, particularly those in certain sectors of the economy, in gaining access to suitable grants and loans are well documented, but your accountant will be able to help in recommending possible sources of finance.

If the immediate problem cannot be resolved in this way, a company might explore the possibility of entering into an informal arrangement with its creditors, such as a debt for equity swap. Alternatively, it can consider taking advantage of one of the statutory rescue mechanisms. The major possibilities, which can be fully explained by a specialist insolvency practitioner, are outlined in the remainder of this section.

Company Voluntary Arrangement (CVA)

The directors of a company can initiate a CVA by drafting a proposal for presentation to the shareholders and creditors of the company, with the object of securing their support for a plan to rescue the company from its immediate problems. Although it is not an essential precondition of a CVA that the company should be technically insolvent, a CVA will usually involve an invitation to creditors to accept a reduction in their claims against the company.

To help them prepare a proposal, the directors will appoint a licensed insolvency practitioner. The practitioner, who during the process of preparing the proposal is referred to as the 'nominee', will make a report on the merits of the proposal to the court. The report includes the nominee's opinion on whether the proposed arrangement has a reasonable prospect of being approved and implemented. Unless the court directs otherwise, he will proceed to summon separate meetings of the company and its creditors to consider and, hopefully, approve the proposed voluntary arrangement. These meetings must be convened and conducted in accordance with detailed procedural rules.

If both meetings vote in favour of the proposal, with or without amendment of it, then the CVA officially takes effect. Most importantly it binds all those, shareholders and creditors, who had notice of the meetings and were entitled to vote at them - even if they voted against.

The CVA procedure therefore allows directors to put together plans to keep their companies going by negotiating some sort of re-structuring of their debts. Since it is dependent on the agreement of a company's creditors, the success of any proposal will depend on it being sufficiently attractive to creditors to persuade them that their position will be more favourable should they accept it than if they pressed for the company to be put into liquidation or administration. The framing of the proposal is therefore to be taken very seriously, and detailed consideration must be given to the company's assets and cash flow prospects.

To provide additional respite to companies at what will usually be a stressful time, private companies which qualify as 'small', as defined by s247(3) of the Companies Act, may take advantage of the option to apply to the court for a moratorium on legal action against them while the approval procedure is set in train. This respite will afford companies a period of respite during which time they cannot be wound up or put into receivership or administration.

As from March 2004, the principal condition which a company must fulfil in order to qualify as 'small' is that it must meet two out of the following three tests:

Turnover not more than £5.6m*
Balance sheet total not more than £2.8m*
Number of employees not more than 50

*As evidenced by its most recent annual accounts.

Note that the CVA procedure is also available to partnerships. The moratorium is also available to small partnerships which meet the above size test.

Administration

Administration is a more formal rescue procedure under which a licensed insolvency practitioner is appointed to a company effectively to take control of it. The administrator investigates the problems facing the company and prepares proposals for achieving the 'objective' of the administration – see below – which he either puts into practice forthwith or, if all creditors cannot be paid in full, presents them for approval to the company's creditors.

Rescue procedures

The immediate benefit to a company in going into administration is that a moratorium takes effect immediately, thus giving it respite from creditor pressure. No winding up action may be taken against the company and no creditor can take steps to enforce security or to repossess goods. At the same time, however, the company's directors lose their power to run the company and the administrator assumes power to do whatever he needs to do in order to achieve the purpose of the exercise. And companies considering administration should also bear in mind that the administrator is also required to make a report to the DTI where he feels that any director of a company in administration is unfit to be concerned in the management of any company – this process may lead to directors being disqualified from holding future office.

Until 2003, administration had to be initiated by the making of a court order. As from 15 September 2003, however, other routes into administration are now possible. A company can still be put into administration via court order, but an administrator can now be appointed by the company by its directors resolving to do so, or by the holder of a floating charge over the company's assets.

Not only have the routes into administration been changed but the nature of the process has been changed significantly. The administrator is now obliged to carry out his tasks in accordance with a hierarchy of objectives, as set out below:

- i) to rescue the company as a going concern
- ii) to achieve a better result for the company's creditors as a whole than would be likely if the company were wound up
- iii) to realise property in order to make a distribution to one or more secured creditors

Objective i) above is now the primary objective to be pursued in all administrations. Only if the administrator thinks that it is not reasonably practical to achieve that objective, or if he thinks that (ii) would achieve a better result for the company's creditors as a whole, is he allowed to pursue that latter objective. Objective (iii) may only be followed if the administrator thinks it is not reasonably practical to achieve either (i) or (ii) *and* he does not, in making distributions to secured creditors, unnecessarily harm the interests of the company's creditors as a whole.

Rescue procedures

Whichever objective he pursues, an administrator is required to perform his functions as quickly and effectively as he can; subject to this, he must always perform his functions in the interests of the company's creditors *as a whole*. This is a major innovation which has important consequences for, in particular, banks and other secured creditors. In respect of finance agreements entered into as from 15 September 2003, floating charge holders lose the right to appoint an administrative receiver to a defaulting borrower company and instead may only appoint an administrator, the core difference between receivership and administration being that, in the former process, the receiver acts primarily in the interests of his appointer and not in the interests of all creditors. There has, therefore, been a significant move towards 'collective' rescue procedures in which all creditors are able to participate.

Company Reconstruction under s425 of the Companies Act
This procedure is not designed primarily as a rescue procedure but nevertheless allows a company to apply to the court to instigate a formal arrangement for the purpose of obtaining creditors' approval for a compromise plan or arrangement. The court will, if it sees fit on receipt of the application, convene a meeting of creditors (or any class of them) with a view to putting the company's proposal before them. If that meeting approves the proposal by a three-quarters majority in value, then when the arrangement is subsequently sanctioned by the court, it is binding on the creditors and the company.

Tables 1 and 2 at the end of this booklet summarise and differentiate between the different forms of 'insolvency' procedures and those procedures whose purpose is specifically to engineer a form of corporate rescue.

Any licensed insolvency practitioner is qualified to advise on appropriate responses to financial difficulties facing a business and to act in respect of an administration or a CVA, or any other formal rescue or insolvency procedure. A list of its licence holders can be obtained from ACCA.

Implications of insolvency for a company's directors

Few directors wish to contemplate the implications for their business and for themselves of the failure of their company. However, it is as well for directors to be aware, in general terms, of the direct and indirect implications of entry into a formal insolvency procedure - administration, administrative receivership or liquidation - well in advance of any insolvency. In addition to the 'wrongful trading' rules outlined earlier, some of the most important are, briefly, as follows:

Review of conduct

Where a company goes into administration (or insolvent liquidation, or administrative receivership), the insolvency office holder who handles the case must make a report to the DTI if he considers that the conduct of a person who is or has been a director of the company renders him unfit to be involved with a company. There are many individual factors which may be taken into account in determining 'unfitness': these include, in addition to factors directly associated with the company's insolvency, any breach of the director's fiduciary duty to his company and the extent of the director's responsibility for the company failing to comply with its various statutory responsibilities, including the obligation to keep accounting records and registers of its members and directors.

On the strength of an adverse report, the DTI can apply to the court for a disqualification order, which can prohibit the person concerned from acting as director, or otherwise from being involved in the formation or management of a company, for up to 15 years.

The office holder must also, as a matter of purely routine procedure, file a return with the DTI within 6 months of his appointment. This return must list all those who had been directors (or 'shadow directors') of the company in the three years before the commencement of the insolvency procedure.

Adjustment of prior transactions

An administrator (or liquidator) may review the company's transactions in the period before the commencement of the insolvency procedure and, in certain circumstances, take legal action to recover money spent by or to avoid transactions undertaken by the company. In this way, the office holder may seek to contest in the courts transactions he thinks have been entered into by the company at an 'undervalue' and transactions which he thinks constitute 'preferences' - these being, in broad terms, transactions where a company consciously gives preferential treatment to one or more creditors over others.

Implications of insolvency for a company's directors

Transactions at an undervalue can be overturned where they have been entered into at any time up to two years prior to the commencement of the insolvency procedure concerned. 'Preferences' can be overturned if they have been given within 6 months of the commencement of the procedure; where the other party is 'connected' with the company, i.e. is a director of the company or a spouse of a director, the review period is extended to two years.

Punishment of malpractice

The insolvency office holder's investigation into the conduct of directors may uncover suggestions of actual malpractice by them. In the case of a winding up, particularly wide powers are available to the liquidator to pursue the errant directors through the courts.

Plan ahead, take advice

Where a business is overwhelmed by adverse circumstances which are beyond its control, such as the insolvency of its parent or of a major supplier or customer, then the opportunities for that business to react and save itself may be minimal. However, companies can and should plan ahead to enable them to withstand resistible pressures.

Ultimately it is the responsibility of a business's directors or proprietors to manage its affairs. This does not mean, however, that they are expected to be experts in aspects of management for which they may have no training.

Chartered Certified Accountants are trained to be of practical help to your business. The preparation of a firm's end-year accounts is by itself an essential exercise in ensuring that the firm's financial position is recorded accurately for legal purposes and to meet the requirements of the tax authorities. Even where the external audit of those accounts is not required by law, audited accounts are widely seen as providing essential assurance of accounts' reliability by lenders of finance and providers of credit. But your accountant can also advise you on many of the specific matters dealt with in this booklet, including financial planning, the setting up of accounting systems and credit and financial management. He or she will also be able to help you with the steps which you should take or consider taking if you consider that your business is in trouble.

If, though, the specialist business support advice which accountants are able to provide is to be fully effective, in terms of helping businesses to maintain and enhance their commercial viability, that assistance must be sought out before the alarm bells start to ring, not after. You should therefore aim to ensure that, with the help of your accountant, you monitor and control your firm's finances sufficiently carefully so as to enable the warning signs to be spotted and dealt with promptly as and when they appear.

TABLE 1: INSOLVENCY PROCEDURES PROPER

Type of procedure	Objective	Characteristics
LIQUIDATION	To terminate the company's existence and to realise its assets to satisfy claims of creditors.	A liquidator is appointed to administer the liquidation and to achieve its objectives. The directors' powers cease.
compulsory	"	The procedure is initiated by an application to the court to wind up the company. The application may be made by the company, its directors or its creditors. The winding up is supervised by the court.
voluntary	"	The winding up is initiated by means of the company passing a resolution to wind up at a general meeting.
members voluntary liquidation (MVL)	"	The company resolution is accompanied by a statutory declaration by the directors that the company will be able to pay its debts in full within 12 months. For this reason the MVL is often called a 'solvent winding up'
creditors voluntary liquidation (CVL)	"	Following the company meeting, a meeting of creditors is convened. A CVL is supervised by the creditors, who may appoint a committee to liaise with the liquidator and to represent their interests.
RECEIVERSHIP	To recover debts owed by a company to a secured creditor	A secured creditor will appoint a receiver, usually without the involvement of the court, to realise those of the company's assets which are covered by the security and to pay the proceeds to it. NB as from 15 September 2003 new floating charge holders lose their right to appoint an administrative receiver to defaulting borrower companies.

TABLE 2: INSOLVENCY PROCEDURES

Type of procedure	Objective	Characteristics
ADMINISTRATION	To achieve the rehabilitation of a company which is or is likely to become unable to repay its debts.	An administrator is appointed either by the company, by a secured creditor or the court. The administrator devises proposals to achieve one of the statutory administration objectives, of which the primary objective is to save the company as a going concern. If approved by creditors the plans are put into action. The procedure provides protection against creditor action against the company.
COMPANY VOLUNTARY ARRANGEMENT (CVA)	To provide a formal framework for a company to propose a binding arrangement to its creditors for the restructuring of its debts.	The directors of a company will prepare detailed proposals to re-structure the company's debts, which are then reviewed by an insolvency practitioner. The proposals are considered by members and creditors; approval will bind all. Small companies can also benefit from a moratorium on creditor action against them.
S425 ARRANGEMENT	To obtain creditors' approval for a compromise plan or arrangement.	On approval of an application, the court will convene a meeting of creditors to consider the proposal. If approved by a three quarters majority in value, and sanctioned by the court, the agreement becomes binding on the company and creditors.

No part of this publication may be reproduced, in any format, without the prior written permission of ACCA.

© The Certified Accountants Educational Trust (CAET) 2004

ACCA UK

29 Lincoln's Inn Fields London WC2A 3EE United Kingdom

tel: +44 (0)20 7396 5910 fax: +44 (0)20 7396 5959 www.accaglobal.com

The Association of Chartered Certified Accountants