JAMESCOWPER KRESTON

Accountants & Business Advisers

Guide to Corporate Insolvency

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Business solvency tests

There are two tests for the insolvency of a business:

- Whether its liabilities exceed its assets (balance sheet test)

- Whether it can pay its liabilities as they fall due (cashflow test)

Whilst these tests should be viewed together it is normally the cashflow test that more critical for the business because if it can be proven that a business cannot pay its debts on time, creditors could look to force that company into a formal insolvency process.

Cashflow management

In order to manage the cashflow of a business it is essential to:

- Know at any time what amounts are owed to the company by customers and what the business owes to its creditors in turn

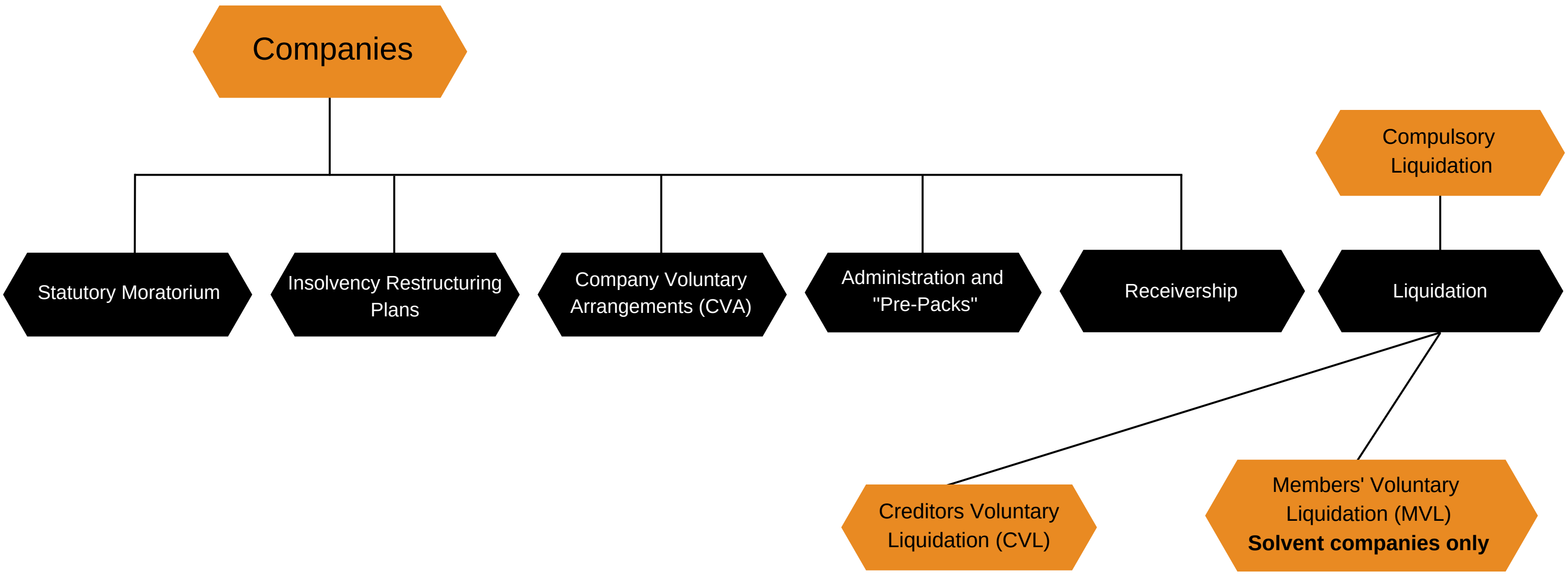
- Send out invoices promptly to customers with clear payment terms and have a rigorous debt collection process

- Incur only expenditure that can be paid for through the business' activity

- Recognise that liabilities to HMRC are as important as those owed to other creditors

- Have headroom within the company's financial resources to meet unexpected liabilities

Figure 1



Insolvency procedures

There are a number of formal insolvency procedures available to companies. We can advise as to the most appropriate procedure given the circumstances and set out the advantages and disadvantages, including the costs, of each (see figure 1).

With the exception of an MVL, a company can only look to a formal insolvency procedure if it is, or is about to become, insolvent.

Statutory Moratorium

The Corporate Insolvency and Governance Act 2020 established a statutory moratorium, which is a period during which eligible companies that cannot or might not be able to pay their debts are shielded from creditors. The moratorium's goal is to provide the company with time to consider rescue strategies or restructuring such as an Insolvency Restructuring Plan (IRP) or sell the business or assets.

A moratorium can be initiated by the directors of the company, without the need for court approval by filing the relevant documents with the court but it does require a Monitor (being a qualified insolvency practitioner) to oversee the moratorium. Prior to obtaining the moratorium the Monitor must state that they consider it is likely that the moratorium will result in the rescue of the company as a going concern.

A moratorium can last for an initial period of 20 business days, which can be extended by the directors for another 20 business days, or by the creditors or the court for longer periods. During the moratorium, the company must be overseen by the Monitor. A moratorium may be suitable for the Company if it needs immediate protection from its creditors while it considers its restructuring options, and if it has sufficient cash flow to continue trading under the directors' control during the moratorium.

The moratorium provides a payment holiday for most pre-moratorium debts, halts insolvency proceedings, prevents enforcement of security by secured creditors and stays other legal proceedings.

Insolvency Restructuring Plans

The Corporate Insolvency and Governance Act 2020 introduced an Insolvency Restructuring Plan (IRP), which allows a company in financial difficulty to propose a binding compromise or arrangement with its creditors and/or members.

An IRP can be used to restructure a company's debts, liabilities, and operations, and to implement a rescue or turnaround strategy. An IRP is similar to a scheme of arrangement and is overseen by the court, but has some advantages, such as the ability to cram down dissenting classes of creditors, and the availability of a moratorium to protect the company from creditor action during the process.

An IRP may be suitable for the Company if it has a viable business that can be preserved or enhanced by restructuring its financial obligations, and if it can obtain a vote in favour of the plan of at least 75% in value of each class of creditors or members that are affected by the proposal. If there are dissenting creditors/members (or classes of each), the court still has the power to sanction the plan in certain circumstances. Once approved the plan binds all creditors/members and the company.

Company Voluntary Arrangement (CVA)

A CVA is a formal compromise a company enters into with its creditors for the discharge of its liabilities. Typically this may involve payments being made over a period of time from future profits; a lump sum introduced by a third party; or sale of certain of the assets of the company to fund the company's obligations under the CVA. The process involves an insolvency practitioner acting as Supervisor of the arrangement.

A CVA is generally initiated by the directors but has to be approved by a requisite majority of the creditors and shareholders.

Administration

An administrator is appointed to take charge of the affairs of the company to the purpose of:

- Enabling the continuation of the company as a going concern
- Achieving a better return for creditors than would be achieved in a liquidation of the company
- Paying secured or preferential creditors

Broadly speaking an administrator can do what is necessary to achieve the objectives which may include continuing to trade the business or selling it. In selling a business he has to ensure that he obtains the best overall outcome for the general body of creditors.

Assessing this is not necessarily as straight forward as achieving the highest possible price but will involve such considerations as security of payment by the purchaser; whether the purchaser will pay some or all of the company's creditors and whether the consideration includes any deferred element.

During the period when a company is in administration it is protected from the actions of its creditors.

Administration can be initiated by the company, its directors or its creditors.

Pre-pack administration

The term 'pre-pack' is often assumed to refer to a specific insolvency process in its own right. However this is not the case. Pre-pack refers to a tactic of marketing and then negotiating a sale of the business and assets of a company prior to that company going into administration with that sale being completed immediately following the administrator's appointment.

Liquidation

There are three types of liquidation (also known as winding up) – creditors' voluntary liquidation, compulsory liquidation and members' voluntary liquidation (which applies only to solvent companies).

Creditors Voluntary Liquidation (CVL)

This is initiated by the directors of a company who have concluded that, by reason of its debts, it can no longer continue to trade. The steps to place the company into liquidation include the convening of a creditors' meeting at which creditors have the opportunity to vote on who should be appointed as liquidator.

The liquidator's role is to realise the assets of the company for the benefit of its creditors and to investigate what has happened in the period leading up to the company's insolvency. The purpose of this investigation is to discern whether any civil proceedings should be taken against the directors or others for the recovery of company assets or contributions to its estate.

Compulsory Liquidation

A compulsory liquidation is often initiated by a creditor of the company. It is a court-based procedure.

If a winding up order is made against the company the Official Receiver (a member of the Government's Insolvency Service), will generally be responsible for the company's affairs but he may choose to appoint an insolvency practitioner to act as liquidator from the private sector to realise any assets.

Members Voluntary Liquidation (MVL)

We have prepared a separate 'Guide to Solvent Liquidations' which available on our website.

How we can help

All our insolvency practitioners are licensed to act by the ICAEW.

Please contact one of our team for more information or to discuss any financial difficulties your company may be experiencing.

Meet the Team

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The information in this newsletter must not be relied upon in any specific case.