SHERIDANS
CHARTERED ACCOUNTANTS

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FACT SHEET
Indicators of Insolvency

The pivotal case on Indicators of Insolvency is *ASIC v Plymin (2003) 46 ACSR 126*. The Judge in this case referred to a checklist of 14 Indicators of Insolvency.

1. Continuing losses
2. Liquidity ratio below 1.0
3. Overdue Commonwealth & State taxes, and statutory obligations
4. Poor relationship with present bank, including inability to borrow additional funds
5. No access to alternative finance
6. Inability to raise further equity capital
7. Supplier placing the debtor on 'cash on delivery' (COD) terms, or otherwise demanding special payments before resuming supply
8. Creditors unpaid outside trading terms
9. Issuing of post-dated cheques
10. Dishonouring cheques
11. Special arrangements with selected creditors
12. Payments to creditors of rounded sums, which are not reconcilable to specific invoices
13. Solicitors' letters, summonses, judgements or warrants issued against the company
14. Inability to produce timely and accurate financial information to display the company's trading performance and financial position, and make reliable forecasts

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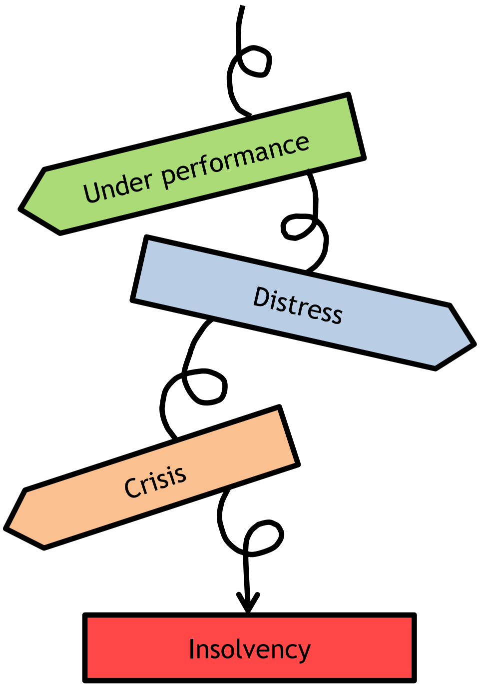
The statutory definition of 'solvent' is contained in Section 95A of the *Corporations Act 2001*, which provides:

> *"95A (1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable.*
>
> *95A (2) A person who is not solvent is insolvent."*

Why is being aware of the indicators of insolvency so important?

- The earlier financial and operational problems are addressed, the earlier the appropriate professional advice can be obtained and corrective action can be taken.
- The early identification of problems usually means that the recovery options and prospects are greater.
- Usually effective turnaround is achieved only in non-crisis recovery situations.
- Early identification and corrective action can increase the prospect of retaining contracts and the support of key stakeholders, to ensure the business does not start to spiral into a fatal crisis.
- The insolvency of a company can have serious consequences for the directors due to insolvent trading and other legal provisions.



A company exhibiting a few of the indicators of insolvency may not necessarily be terminally insolvent but may be simply experiencing short-term cash-flow problems, if those problems can be overcome in the short-term.

Clearly, the directors and management need to carefully consider and evaluate the position of the company where several indicators of insolvency are noted.

If the directors of a company suspect that the company is in financial difficulty, they should seek professional advice as early as possible, as this increases the likelihood of the company's survival.

Directors cannot afford to have a "head in the sand" attitude, hoping that things will improve. They rarely do.

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