

## **LOOK BEFORE YOU LEAP**

### **Sizing Up Your Insolvency Options**

#### **INSOLVENCY REFORMS: DETERMINING THE ELIGIBILITY**

The insolvency reforms are designed to reduce the difficulties and expenses faced by a small business when reshaping their financial activities to continue in the future, visa-a-vis the presently available options. In October 2020, the Australian Federal Government announced specific reforms targeted at helping small businesses restructure and strategize when they encounter any financial difficulty, especially with the adverse economic effects caused by the global coronavirus pandemic.

This Small Business Restructuring Plan, popularly referred to as the “VA Light process” by top industry experts, kick-started on the 1st of January 2021, when all the temporary relief measures covering insolvent trading and debt pursuit ended.

#### **IMPORTANCE OF REFORMING NOW**

It is crucial for the Insolvency Reforms to commence immediately for the following reasons:

**SAFETY MEASURES:** According to reports, despite the advent of COVID-19, the number of corporate solvencies has reduced drastically by about 50% compared to the previous year due to temporary safety measures introduced to ensure businesses' survival. Unfortunately, all these measures expired at the end of the year, which might spike an increase in financial difficulties for small business owners. Therefore, these reforms must be in place as safety measures for small businesses.

**JOB CREATION PLAN:** This is part of the Australian Federal Government's strategies to create employment. If the reforms are successful, it will enable more small businesses in Australia to quickly restructure, reshape, and develop better strategic plans for surviving the adverse economic effects of COVID-19.

**HIGH VULNERABILITY TO INSOLVENCY:** Over the years, small businesses are more prone to becoming insolvent when the economy melts down. For instance, approximately 80% of corporate insolvencies involve companies with less than 20 employees and less than \$1 million in liability.

Consequently, the Insolvency Reforms must run smoothly to ensure up and coming businesses' economic stability.

## **HOW TO RESTRUCTURE DEBTS**

As a small business owner, when you want to restructure your debts, here are the steps and processes to follow:

**Up to 20 Business Days:** When a small business is in debt, the directors of a financially distressed company's first action is to assess the damage. Is the business mortally wounded? What caused it? Where does the business stand now and what options does it have? Take experienced professional advice from accountants, lawyers and insolvency practitioners in this assessment and planning process before deciding. Choose which insolvency option is best for the business. Is it the "VA Light", creditors liquidation, a deed of company agreement or indeed a voluntary administration that will offer the best outcome?

To proceed with the "VA Light" process first appoint a Small Business Restructuring (SBR) practitioner. The practitioner will carry out the responsibility of confirming the company's eligibility to access the restructuring process.

Next, a notice of process commencement will be provided to the creditors through a technology-neutral means. This notice will outline how information that is relevant to the process can be accessed.

Then a restructuring plan is developed by the company's directors with the help of the SBR practitioner. Based on their assessment of the company's financial affairs, the practitioner determines whether to certify the plan. After the evaluation, the program containing the information and certificate are finally made available to creditors.

Up to 15 Business Days: The second step involves creditors voting on the plan, thereby verifying proof of the debt through an online portal or any other available technology-neutral means. The approval requires a majority of unrelated creditors by the number of people who respond by the deadline.

There are two ways in which this step can go. Firstly, if a majority of the creditors vote in favour of the restructuring plan, the program commences, and the practitioner is appointed to supervise the program. On the other hand, if a majority of the creditors vote against the restructuring plan, the process comes to an end. The directors Can then choose an alternate insolvency process.

However, it is essential to note that the small business directors remain in control of the business's day-to-day activities during the steps mentioned above. Therefore, it makes this process significantly different from the Voluntary Administration (VA) process, where a Voluntary Administrator receives the total control of the business' affairs when they are appointed.

## **ELIGIBILITY CRITERIA FOR THE RESTRUCTURING PLAN**

For small businesses to qualify and be eligible for the Insolvency Reform plans, the company must meet the following requirements:

**INCORPORATED ENTITY:** The small business must be an incorporated entity to have access to this plan.

**CORPORATE LIABILITIES:** The business's corporate liabilities must not exceed \$1 million, including all related party liabilities.

**UPDATED TAX LODGEMENTS:** The company's tax lodgement must be up to date, even if they have not been able to pay associated liabilities.

**PAYMENT OF EMPLOYEE ENTITLEMENT:** The company must have paid all employee entitlements which are due and payable before the directors can be forwarded put the plan to the creditors for commencement.

Once all these requirements are met, any small business can successfully enjoy the insolvency plan's coverage. However, it is essential to note that the Insolvency Reforms do not deal with small businesses' trading trusts.

## **FACTORS TO CONSIDER WHEN IN FINANCIAL DISTRESS**

With the emerging insolvency reforms, there are now several available options that small business directors can consider when strategising on the way forward for their business. Some of the factors include:

**SEEK EXPERIENCED ADVICE:** Usually there is no single cause of financial distress and therefore the road to recovery will involve complex, multifaceted strategies implemented over time. The “VA Light” process will be only one facet of the plan. It is essential to engage the support of experienced, practical, and technical advisors who understand business and the insolvency pathways to guide the recovery project.

**CRITICALLY ASSESS FINANCIAL INFORMATION:** Accountants and practitioners can help clients ensure that an accurate and informed assessment of financial information is undertaken. Clients must Understand cash flow, liabilities, and cash reserves and have realistic estimates of what is possible before deciding which insolvency pathway to choose.

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