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NZTE Guidance: Solvency and COVID-19

Solvency considerations within the pandemic context

NEW ZEALAND
TRADE & ENTERPRISE
Te Taurapa Tūhono

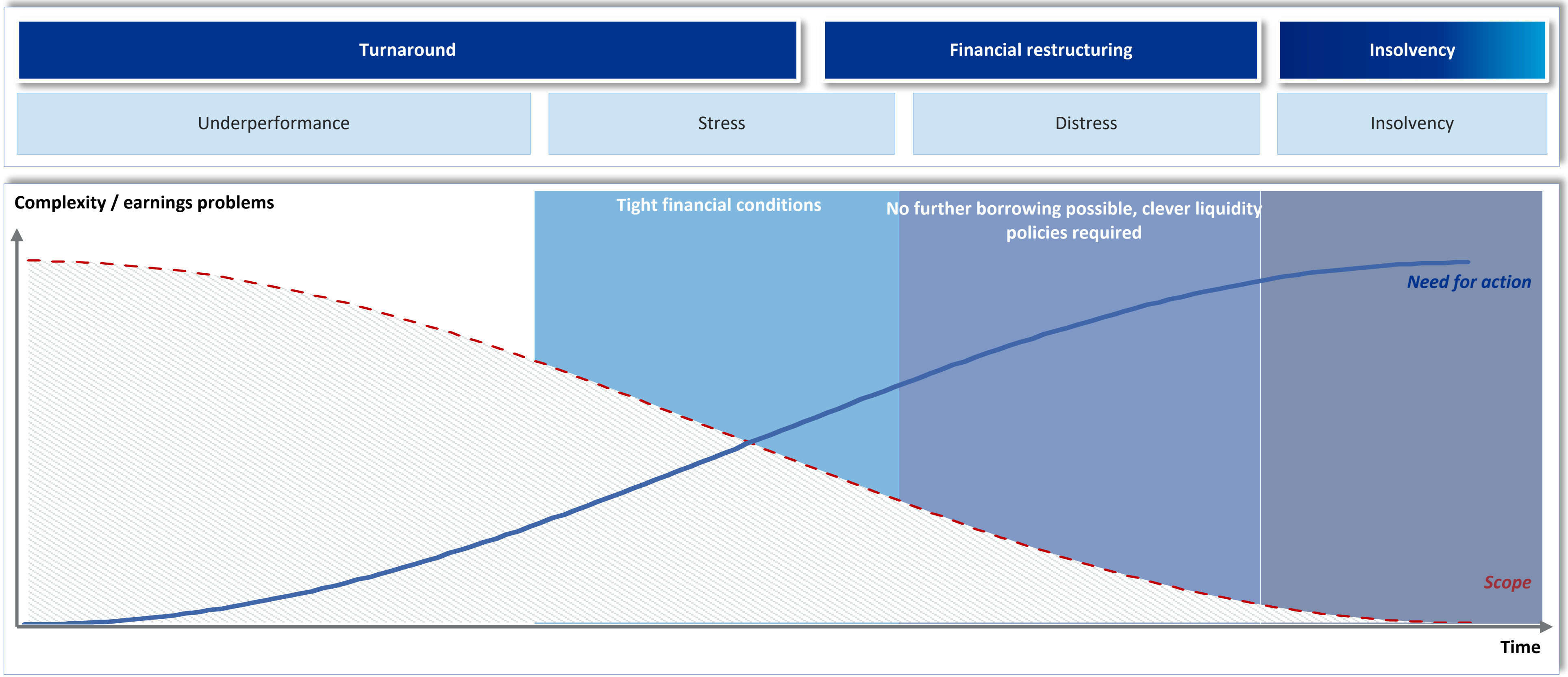
KPMG

Introduction

Solvency issues will become a key consideration for many directors in the current trading environment, given that COVID-19 is expected to have a greater adverse impact on the NZ economy than the 2008 global financial crisis and is unfortunately likely to trigger numerous business failures.

As domestic and global containment measures take effect, many businesses will experience a significant fall in trading levels and cashflow. Directors will need to be mindful of the impact on the solvency of their business and carefully consider whether continuing to trade is in the best interests of the company and its creditors.

This paper provides practical guidance for directors that are considering issues of solvency. Optionality for stakeholders is likely to become more limited as the business comes under increasing financial stress. Acting now with some of the lighter actions may defer or lessen the requirements for more extreme measures further down the track. None of these choices are without consequences.



Insolvency

Legal definition of solvency

Under the Companies Act 1993 (**Companies Act**) a company is solvent when:

- it is able to pay its debts as they become due in the normal course of business (known as **Cash Flow Solvent**); and
- the value of its assets is greater than the value of its liabilities (including contingent liabilities) (known as **Balance Sheet Solvent**).

Cash Flow Solvency

A company will typically be considered Cash Flow Solvent when its current expected cashflow and future receipts for a forecasted period are sufficient to pay its currently due/forecasted payments. In assessing whether a company is Cash Flow Insolvent consideration should be given to:

- whether the company is consistently in arrears with its creditors;
- whether the company's current receivables are likely to be recoverable;
- the likely level of future sales during the COVID-19 restrictions and once the restrictions are lifted;
- whether there are any plans in place to address the cash flow deficiency and the feasibility of those plans (e.g. raising equity or debt to assist with cashflow);
- the likelihood of customers seeking refunds or relief from their obligations; and
- any upcoming debt amortisation or covenant testing requirements.

Further information regarding how to manage your cashflow through COVID-19 are available on NZTE's website.

Balance Sheet Solvency

When assessing whether a company is Balance Sheet Solvent scrutiny needs to be given to whether the company's assets and liabilities represent market value and the true financial position of the company. In particular it should be considered:

- whether goodwill has been tested for impairment and represents fair value at the time;
- whether related party receivables and shareholder loans are recoverable or intended to be repaid;
- whether there is a significant difference between the book value and market value of fixed assets; and
- the appropriate value of any contingent claims (i.e. claims for damages).

Indicators of insolvency

The COVID-19 scenario is putting businesses under commercial pressures that may lead to solvency issues. Some other indicators that a company may be insolvent (or close to insolvent) are:

- defaulting on loan or banking facility covenants;
- an increase in overdue aged payables;
- a declining current ratio (current assets ÷ current liabilities) or a current ratio of less than 1;
- overdue tax liabilities and/or incurring associated interest and non-payment penalties on tax liabilities; and
- shifting debt from one place to another.

COVID-19 and solvency

The COVID-19 scenario, and in particular the lockdown, is likely to put solvency pressures on companies in a number of ways:

- The company ceases to trade and receive revenue during the lockdown period while fixed costs continue to be incurred. If the company does not have sufficient cash reserves or receipts from debtors to fund ongoing trading it may become Cash Flow Insolvent. Or it gradually becomes Balance Sheet Insolvent as its assets (cash reserves and receivables) are depleted as they are used to fund losses.
- The company raises debt to fund its operating costs and its balance sheet deteriorates and it gradually becomes Balance Sheet Insolvent.
- The company is owed money by a debtor or debtors that become unrecoverable as the debtor does not pay and/or enters an insolvency process, this will weaken both the balance sheet and cashflow of the company.

Directors and insolvency

Implications for directors

Trading a company whilst it is insolvent places its creditors at serious risk. If the company fails its creditors may go unpaid and hence even become insolvent themselves. Although directors may be optimistic about a company's future and want to carry on their business there is a risk that they are placing other businesses in danger by incurring liabilities that they cannot pay. There is also a risk that they will be held personally liable for the company's debts for insolvent trading (a well documented example is *Mainzeal Property Construction Limited (in liq) & Ors v Yan & Ors*).

Liability for insolvent/reckless trading arises through directors' statutory duties under the Companies Act. The duties most relevant to insolvency scenarios are the duties to:

- act in good faith and in the best interests of the company;
- not allow the company to trade in a manner likely to create substantial risk of serious loss to the company's creditors (i.e. trade whilst insolvent);
- not incur an obligation unless they believe the company will be able to perform the obligation when required to do so; and
- exercise their powers/duties with the care, diligence and skill that a reasonable director would exercise in their circumstances.

The most common way these duties are breached (and a director becomes personally liable for company debts) is where a director allows a company to trade while it is insolvent in circumstances where it would not be objectively reasonable to do so.

Although a company may be financially distressed and/or temporarily insolvent this does not mean a director will have immediately breached their duties to the company. What is required when a company enters troubled waters is for its directors to carry out a sober assessment as to the company's likely future income and prospects. This assessment is not a one-off exercise and instead requires consistent and regular monitoring of whether the company is financially viable and:

- whether continuing to trade the company's business is in its best interests (and the interests of its creditors); and
- whether the company has the ability to trade out of its distressed position.

By constantly carrying out assessments of this nature directors can gain comfort that they are taking a legitimate business risk rather than breaching their duties under the Companies Act through reckless/insolvent trading. Any directors that remain uncertain about compliance with their duties after considering the above factors should seek clarification from a suitably qualified legal and/or insolvency practitioner.

Safe harbour regime

The New Zealand Government has announced an intention to temporarily amend the Companies Act to allow businesses a degree of flexibility and build confidence. One of these changes is the introduction of a 'safe harbour' regime, a change that provides a degree of protection for directors from insolvent trading claims.

Although further details on the safe harbour regime are to be announced, it appears as though, over the next 6 months, directors who decide to keep trading will not breach their duties if:

- in the good faith opinion of the directors, the company is facing or is likely to face significant liquidity problems in the next 6 months as a result of the impact of the COVID-19 pandemic on them or their creditors; and
- the company was able to pay its debts as they fell due on 31 December 2019; and
- the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (e.g. because trading conditions are likely to improve or they are likely to be able to reach an accommodation with their creditors).

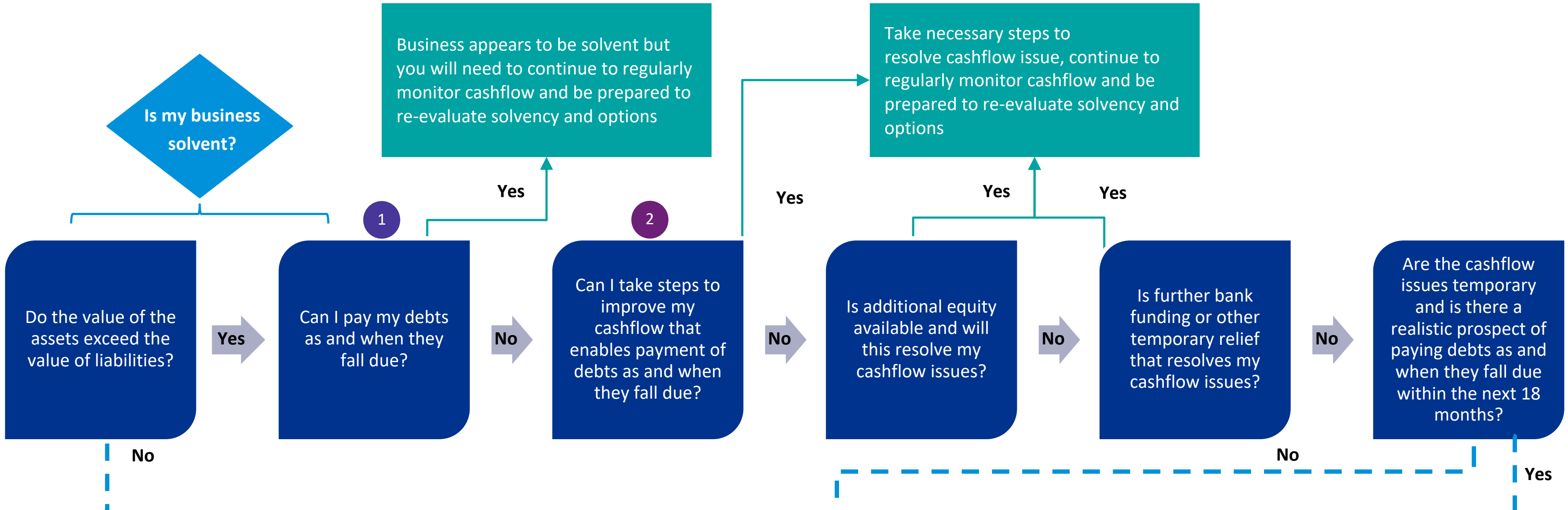
It is important to note this safe harbour regime does not provide a blanket exception to insolvent trading. Directors need to remain cognisant of their company's financial position and future prospects.

To comply with the good faith requirement of the safe harbor regime (and when sitting on the board of any distressed business generally), at a minimum we consider boards will need to prepare and consider on a continuous basis:

- **Short term cashflow forecasts that show how you can manage existing cashflow requirements**
- **A robust 18 month three way (P&L, balance sheet and cash flow) forecast based on reasonable and supportable assumptions**
- **A plan to manage liquidity and creditors, including any additional credit incurred during the period;**
- **A restructuring plan that sets out opportunities to reduce costs, improve cashflow and bolster the balance sheet;**
- **A communication plan to agree a path forward and reporting requirements for key stakeholders; and**
- **A governance process to monitor the financial position and properly record key decisions regarding trading and solvency.**

Solvency pathways

Summarised below is an indicative decision tree to assist stakeholders when considering next steps for a business facing cashflow solvency issues.



Undertake a sober assessment as to whether continuing to trade is in the best interests of the company and its creditors.
Consider seeking financial and legal advice around your obligations and options

Consider:

- Current maturity of the business (i.e. is the business a recent start up) and whether the equity position is reflective of the current business lifecycle
- The realistic market value of the business' assets
- The future prospects of the business
- Whether the business has supportive stakeholders to fund ongoing trading
- Opportunities to sell the business and assets (or selected components of the business and assets)
- Balance sheet restructuring options (i.e. informal or formal creditor compromises)
- Opportunities to raise additional equity
- Balance sheet restructuring options (Informal arrangements with creditors or formal creditor compromises)
- Insolvency options

Consider:

- Opportunities to sell the business and assets
- Balance sheet restructuring options (i.e. informal or formal creditor compromises)
- Insolvency options

Consider:

- The business Debt Hibernation Scheme
- Mothballing the business until normal trading can resume
- Balance sheet restructuring options (i.e. informal or formal creditor compromises)
- Voluntary Administration to provide a moratorium while the Administrator considers rehabilitation options

Notes:

1 We recommend preparing a 17 week cash flow forecast to understand your short term position as well as a 12-18 month forecast to understand the mid-term impacts. The NZTE cash flow forecast tool is available to assist you with this process.

2 Consider the following mitigation strategies, prioritised in order: **No regrets:** Chase debtors, maximise existing payment terms; **Tactical:** Defer capex spend, renegotiate trade terms, remove or defer unnecessary costs; **Emergency:** Defer non-wage payments.

Avoiding/mitigating insolvency

Focus points

When a company is distressed its board and management can potentially avoid/mitigate insolvency by:

— **Cut costs** – carry out a detailed review of your businesses expenditure and reduce any non-essential or discretionary costs.

— **Keep cash in your business longer** – pay your creditors on the day they are due (and not earlier) or otherwise look to improve trading terms to assist in alleviating cashflow timing pressures.

— **Consider your working capital requirements** – if additional working capital is required to assist with short term cashflow explore whether this can be achieved through asset divestment, debt factoring or raising equity/debt.

— **Engage with your bank as soon as possible** – manage your risk of the bank enforcing its security and discuss your short – mid term plan.

— **Engage and negotiate with creditors early** – consider and propose payment deferment/instalment arrangements to creditors and explain how this will benefit the creditor (e.g. that in a fire sale liquidation scenario they may receive much less).

— **Monitor debtors closely** – consider requiring cash on delivery if they are consistently late on payment and/or consider including a lien or specific security over your goods in your contract terms if supplying credit.

— **Focus on liquidity and managing debts** – have both a short-term and long-term plan and forecast. Ensure that addressing the company's short term pressures does not result in it having no long term viability.

COVID-19

The COVID-19 scenario has unique commercial pressures as well as unique options for relief for distressed companies. Companies can alleviate insolvency pressures by:

— **Take advantage of the Government business package** – assess whether your business qualifies for the government wage subsidy and utilise the tax advantages.

— **Assess your sector's exposure** – some sectors will take longer than others to recover or are unlikely to return to business as usual after the COVID-19 lockdown is lifted (e.g. international travel restrictions may stay in place putting tourism under prolonged pressure). Make sure to consider your sector's exposure and recovery lag time when assessing your business' future prospects.

— **Consider ceasing operations** – evaluate a scenario where you cease business operations during the COVID-19 lockdown period against the limited operations you may currently be maintaining (with the view to re-commencing operations post-lockdown).

— **Engage with your bank and Inland Revenue** – Inland Revenue and the banks have publicly indicated they are open to relief discussions with affected businesses.

— **Discuss relief with your landlord** – you may be entitled to relief under your lease or your landlord may be able to pass on the benefits of their own mortgage holiday to you in the form of reduced rent.

— **Review your contracts and insurance policies** – contracts your company is party to may have relief provisions and the COVID-19 scenario may be a covered event under your insurance policy.

— **Think long term** – although government handouts and further bank facilities are readily available to alleviate short term pressure, ensure you are not overleveraging and that your business can service this debt in a business as usual scenario (while hopefully still providing a return to shareholders).

Practical steps

Some practical steps that can be taken are:

— **Board monitoring** – ensure the board meets regularly (at least weekly) to continually assess and evaluate the company's financial position and viability.

— **Document board decisions** – accurately record all board decisions as well as the reasons for those decisions and any budget, forecast or other financial information relied upon.

— **Report and budget** – prepare and maintain up to date financial information (cashflow forecasts and budgets, balance sheet information).

— **Have controls on expenditure** – tighten controls on expenditure approval and maintain closer oversight on expenditure.

— **Mothball** – consider whether you can cut short term costs and survive the lockdown period by maintaining only the skeleton of your business operationally with the view to rebuild capacity post-COVID-19.

— **Communicate** – maintain open and transparent lines of communication as to the company's position with management, creditors and debtors.

— **Seek legal advice** – discuss your position with a corporate or insolvency lawyer to ensure you are not at risk of breaching your duties to the company.

Distribution of assets and funds

Insolvency stakeholders

The Companies Act prescribes the order in which creditors and its shareholders are paid from the company's assets in an insolvency scenario, and in particular the priority of payment amongst different classes of creditors.

If you suspect your company is insolvent and are liquidating assets to pay debt, you will need to consider the relevant security interests and statutory priorities. Failing to do so may lead to a liquidator later having recourse against the recipient of funds, or you as a director. Similarly when receiving payment from a debtor you believe is distressed you should ensure you are receiving the payment in the correct priority and/or making an internal provision for these funds to be potentially clawed back in an insolvency (other than if the funds were received from a business using a business debt hibernation agreement).

Understanding how the "waterfall of funds" flow in an insolvency scenario is also important when preparing a compromise for your creditors. These priorities can be analysed so that you can show how much funds a particular class of creditor is likely to receive under a particular proposal vs in an insolvency scenario. This priority order is typically:

Secured creditors (if funds are proceeds from the sale of secured assets)	**Preferential creditors** (in the order detailed below)	**Non-preferential unsecured creditors** (on a pro-rata basis)	**Shareholders** (on a pro-rata basis)

Secured creditors

Secured creditors have first priority to the proceeds from the sale of any assets their debt is secured against. There are three main types of security interests, these are those securing debt:

— by a general security agreement (**GSA**) over all present and after acquired personal property (e.g. a bank loan or overdraft facility);

— by a purchase money security interest (**PMSI**) which secures the debt against a specific asset that was purchased with the funds the secured creditor lent (or on credit) (e.g vehicle finance); or

— a specific security agreement over a specific asset (with the funds lent not being used to purchase that asset) (e.g. offering a piece of equipment as security for the debt).

Secured creditors will generally rank in priority amongst themselves by the earliest date they registered their security with the exceptions that:

— a GSA does not have priority to the company's accounts receivables and inventory (preferential creditors do); and

— a PMSI has super priority to the proceeds of the sale of its secured asset (even if a GSA was registered prior).

If all assets have been realised and secured debt remains then the remainder of a secured creditor's debt will rank as non-preferential unsecured.

Preferential creditors

Preferential creditors are the highest ranking unsecured creditors. Preferential creditors have five tiers of priority and should be paid in this order:

1. A liquidator and their fees (if any)
2. Employee entitlements (on a pro rata basis)
3. Layby sales (on a pro rata basis)
4. The costs of a compromise with creditors (if any)
5. GST, PAYE, NRWT, RWT and certain customs duties (on a pro rata basis)

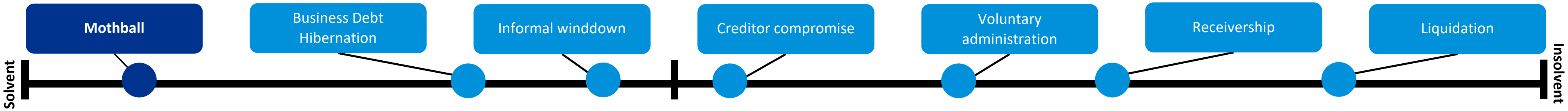
Non-preferential unsecured

Non-preferential creditors are subordinate to preferential unsecured creditors. Non-preferential unsecured creditors rank equally amongst themselves on a pro-rata basis. Secured debt that exceeds the value of the security ranks as non-preferential unsecured debt.

Shareholders

After all a company's creditors have been paid in full any surplus assets are to be distributed in accordance with the company's constitution. If the company's constitution does not prescribe a method of distribution then the surplus should be distributed to the company's shareholders on a pro-rata basis.

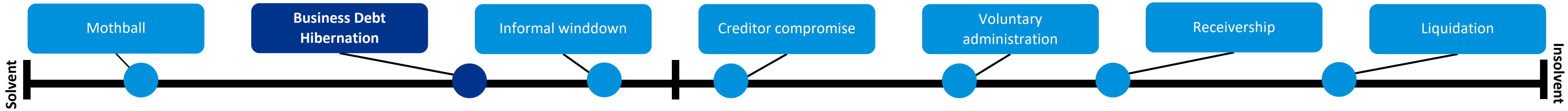
Mothball your business (temporarily cease trading)



During the COVID-19 containment and lockdown period, businesses may consider whether to 'mothball' their businesses by temporarily ceasing trading with the view to recommence operations once the lockdown is lifted. This could involve completely ceasing all operations and most expenditure, or retaining the skeleton of operations required to continue operating through this period.

When is this the right process?	— When your company has a **moderate to strong balance sheet** but is suffering from **short term cash flow pressures**. — When you have **sufficient cash reserves to cover your minimum fixed costs** in the short term (or can raise capital to do so without becoming Balance Sheet Insolvent). — There are **limited short term prospects** of trading returning to a breakeven level.
What do I need to do?	— **Identify your unavoidable fixed costs** – carry out analysis on the minimum fixed costs your business needs to incur during a mothball period. Consider whether these can be reduced further – does your lease have a clause allowing for reduced rent due to an inability to access the site? Do any of your other contracts have similar clauses (e.g. insurance)? — **Forecast your cashflow requirements during the mothball period** – if there's a deficiency, is bridging this with existing equity achievable? Do/when will you require further capital? — **Consider whether you have financial support from a financier or shareholder** – where can you raise further capital from? Even if further working capital isn't required per your forecasts it should still be considered as a contingency (in case the lockdown period is extended or your business is otherwise adversely impacted by COVID-19). — **Analyse whether your business can service more debt** – if debt is required to alleviate short term pressures can your business service this debt in a business in a constrained economic environment? — **Consider whether you qualify for the Government wage subsidy** – has your revenue declined by 30% or more as a result of COVID-19? — **Consider how much you can pay your staff** - if you receive the government wage subsidy you must pay your staff 80% of their normal pay "where reasonably possible". Consider the impact of topping up your staffs' pay to 80% on your short term cashflow. Can you afford this? Or should you decrease your payroll costs further for the short term? — **Develop a communications strategy for stakeholders and the market** – communicate your intentions to recommence operations to trade partners and employees. Ensure that you have a robust plan to communicate your re-entry to the market to your customers.
What are the risks?	— **Don't overleverage your business** – ensure that your mid-term forecasts support a case for raising further debt to alleviate short term cashflow pressures. — **Consider your sector's exposure** – consider how long it will take for your sector to correct. Some sectors may take much longer to correct than others (e.g. international tourism as borders are likely to remain closed past the lockdown period). — **Consider how onerous your fixed cost base is** – this will likely determine how viable mothballing is. If your fixed costs are too onerous then it may be best to consider winding up your businesses' affairs and realise any equity rather than have it depleted to meet short term cash flow needs. — **Consider your company's forecast balance sheet** – what will this look like at the end of the lockdown period? Will your business still be balance sheet solvent? — **Account for the one off costs you will incur when re-commencing operations** – ensure you will have sufficient cash to meet these costs and the working capital investment at the end of the lockdown period (e.g. recruitment, stock and inventory, advertising).
How do I govern the process?	— **Directors should document their decisions** to temporarily cease trading and the reasons for that decision and forecasts relied upon (in board resolutions or minutes). — **Continue to monitor** cashflow and prospects of a recovery.
What is the likely outcome?	The ideal outcome of a mothball process is that the company recommences its operations post COVID-19 and has a stronger balance sheet and capital structure than it otherwise would have had (due to its reduction of outflows during the mothball period).

Business Debt Hibernation



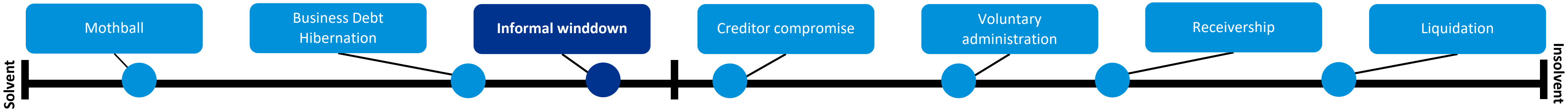
The Government has announced they will be introducing legislation to create a Business Debt Hibernation scheme (**BDH Scheme** or **Scheme**) to provide temporary relief from the impacts of COVID-19. The BDH scheme will be a formal process intended to be a simple, self-help regime for companies to place existing debts in hibernation and obtain the benefit of a moratorium through the hibernation process. The key features of the proposal are:

- it applies to companies, partnerships, trusts but not licensed insurers, registered banks, or non-bank deposit takers;
- directors will have to meet a threshold before being able to access the Business Debt Hibernation regime and putting a proposal to their creditors;
- creditors will have a month from the date of notification of the proposal to vote on it, with the proposal going ahead if 50% (by number and value) agree;
- if the voting thresholds are met, it will be binding on all creditors (other than employees) and subject to any conditions agreed; and
- there will be a one month moratorium on the enforcement of debts from the date the proposal is notified, and a further 6 month moratorium if the proposal is passed.

The scheme and details relating to it are subject to further drafting and approval by Parliament. The summary below is based on information currently available.

When is this the right process?	— When your company has a **distressed to moderate balance sheet** and is **suffering from short term cash flow issues**. — When your **creditors are likely to commence enforcement action** against you to recover their debt (or already have). — When you **need breathing space** to formulate a substantive restructuring plan.
What do I need to do?	— **Analyse the outcomes for your creditor** – what are your respective creditor classes likely to receive in an insolvency scenario? Will they be better off if you utilise the BDH Scheme while you formulate a substantive restructuring proposal (e.g. the sale of your business, a creditor compromise, or pre-packaged voluntary administration) or otherwise to allow the business to build up reserves from ongoing trading? — **Identify the creditors you need support from** – which creditors make up 50% in value of your total creditors and are likely to support a BDH Scheme proposal? Should you have informal discussions with them prior to putting forward a proposal? Which other creditors do you need support from to reach 50% in number? — **Plan out your communications strategy** – how will you reach out to the most important creditors prior to putting forward to a BDH Scheme proposal? How will you communicate to your creditors that they will be better off by approving the proposal? — **Issue the proposal** – process to be confirmed once relevant legislation has been passed. — **Plan your restructuring proposal** – review your company's prospects and consider whether you can achieve the sell down of non-essential assets yourself. Or, if you're considering a business sale and/or formal insolvency process speak with a legal advisor and/or insolvency practitioner.
What are the risks?	— **Act swiftly**– if you are facing creditor and cashflow pressure and consider that the BDH Scheme will allow you time to reorganise your affairs and improve your company's long term prospects, you should act quickly to preserve cash and optionality. — **Have a mid-term plan** – the BDH Scheme is not a plan of itself and only prevents creditors taking enforcement action against your company in the short term. Without a plan to restructure your business the Scheme is only delaying the inevitable.
How do I govern the process?	— **To be confirmed** – this process is to be confirmed once the relevant legislation has been passed.
What is the likely outcome?	A business is given either 1 or 6 months of breathing room to trade out of its position or formulate a substantive restructuring proposal.

Informal winddown



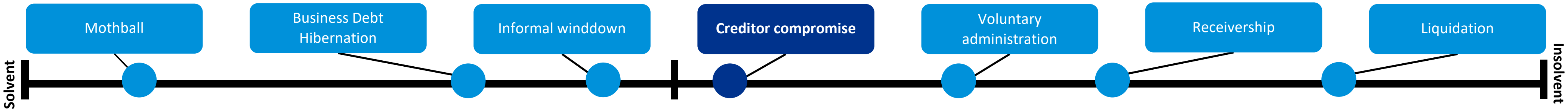
If a company has poor future prospects, but is currently solvent, some directors can initiate an informal winddown process. This would involve the sale of the company's assets and winddown in trading activity either in part or in full. Consider whether this is best managed by the business or the appointment of a liquidator.

When is this the right process?	— When your company is **solvent** and is **suffering from cash flow issues**. — When your forecasts indicate that your company will **not be able to trade out of its current position**. — When you and/or your shareholders **want to exit your company** and realise any existing equity without going through a formal insolvency process**.**

What do I need to do?	— **Obtain market valuations for your assets** – ensure you obtain the appropriate valuation and liquidate the asset for as close to market value as possible. Transactions can be challenged later in an insolvency process if market value is not received.
	— **Engage brokers to assist in the sale of your assets** – if you do not have a purchaser already lined up then engage the appropriate brokers (e.g. real estate, business, or auctioneer) to assist in the sale process. Using a broker also evidences that you ran a competitive sale process and obtained market value.
	— **Analyse creditor positions and distribute funds** – review your creditor portfolio and ensure that you calculate each creditor's entitlement to a distribution from the company's assets in accordance with the Companies Act (refer to the earlier page on distribution of assets for guidance). Communicate the proposed distribution plan with creditors to deal with any potential challenges to the proposal as early as possible.
	— **Pay your taxes** – ensure you pay any taxes incurred throughout the winddown process as tax arrears could result in Inland Revenue applying to liquidate your company later.
	— **Apply to have the company removed from the Companies Registry** – after all funds have been distributed you can apply to have the company removed from the Registry on the basis that either:
	    — the company has discharged in full its liabilities to all known creditors and distributed its surplus assets; or
	    — the company has no surplus assets after paying its debts in full or in part and no creditor has applied to court for the liquidation of the company.

What are the risks?	— **Be mindful of your duties to the company** - if the company is distressed it is important that directors are still considering their duties and that their actions in an informal winddown are in the company's best interests. Failing to do so may lead to transactions and/or the conduct of the directors being challenged in a later insolvency process. — **Consider a formal insolvency process** – a formal insolvency process carried out by a professional does not carry the risk of you making an incorrect decision or distribution that may lead to claims being made against you personally. Weigh this risk against the downsides of a formal insolvency process (which is typically the cost and lack of control). — **Ensure you obtain market value** – this will reduce the possibility of creditors or other parties challenging the transactions, process or your conduct later. — **Ensure the company's funds are distributed correctly** - the company's funds are distributed to creditors in accordance with the Companies Act (refer to the earlier page on distribution of assets).
How do I govern the process?	— **Document your decisions** – The decision to winddown a company's business in part of full should be accompanied by a board resolution and/or board minutes documenting the decision and reason for doing so.
What is the likely outcome?	The company could wind down non-essential operations and realise these assets or wind down its operations and realise its assets in totality. Ideally a partial winddown would result in the company's cashflow and/or balance sheet solvency improving along with its future prospects. A full winddown will result in all of the company's assets being liquidated and distributed to its creditors.

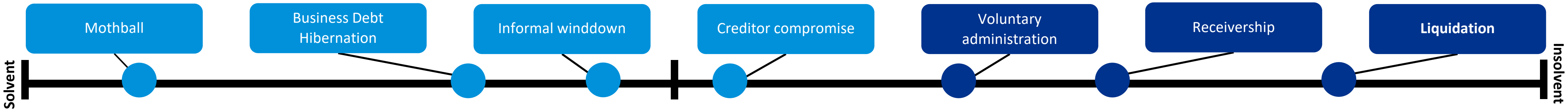
Creditor compromise



A creditor compromise is a formal process through which a company may enter into binding compromises with its creditors to cancel all or part of their debt or vary the terms of that debt.

When is this the right process?	— When **your company is insolvent** (either Cash Flow Insolvent or Balance Sheet Insolvent) **but could become solvent** (or trade its way to solvency) by deferring, devaluing or changing the terms of its debts. — When **majority of your creditors are likely to approve a compromise** (e.g. because they value your continued business or are likely to receive more value through a compromise than an insolvency process). — May be used **in conjunction with the BDH scheme** to provide a moratorium and to restructure the balance sheet.
What do I need to do?	— **Your company must be insolvent** – it is a prerequisite that your company is unable to pay its debts (or you have reason to believe it is unable to). — **Consider engaging a legal advisor/insolvency practitioner** – although neither are required it is recommended that you have an advisor guiding you through the process. — **Analyse your creditor profile** – how much will they receive in an insolvency (e.g. liquidation) if your assets are sold in a fire sale scenario? Are they likely to do better through a compromise and agree to the proposal? — **Formulate a proposal** – a compromise will most often propose to cancel all or part of creditor debts or vary the rights of creditors or the terms of debts. — **Have your board vote** – on putting forward a compromise proposal to the company's creditors. — **Draft and issue a notification of proposed compromise** – this notice must be in the form detailed at section 229 of the Companies Act and invite creditors to a meeting to vote on the proposal (with at least 5 working days notice of that meeting). — **Hold a creditors meeting** – have your creditors vote on the compromise at the creditor meeting (held in accordance with Schedule 5 of the Companies Act). A majority vote of 75% in value or in class of creditors is required to approve the compromise.
What happens next?	— If it is **approved,** the terms of the compromise are binding between the company and its creditors (even those that did not vote in favour of the compromise). — If it is **not approved,** the company has now declared its insolvency to its creditors and should consider an insolvency process such as a voluntary administration or liquidation immediately.
How do I govern the process?	— **The board leads the process** – the only party that can put forward a creditor compromise from the company's side is its board of directors. The board should ensure that the decision to propose a compromise and the reasons for doing so are well documented by a board resolution to put forward the compromise and board minutes.
What is the likely outcome?	— If a creditor compromise is approved the company is obligated to make payment to creditors in accordance with the terms of the compromise, and the creditors are bound from enforcement until there is further default. The compromise should ultimately reduce the liabilities on the company's balance sheet or its cash flow pressures and allow it to trade out of insolvency. — If the creditor compromise is not approved the board should consider an informal wind down and/or other formal insolvency processes.

Formal insolvency options



	Voluntary administration	Receivership	Liquidation
What is it?	A voluntary administration (**VA**) is a formal process used for companies that have the potential to be rehabilitated (returned to a solvent position). The VA process is typically used where a company is insolvent (or will be shortly) but still has a business or other assets of value. A VA initiates a period where the affairs of the company are "frozen" which allows breathing space for an administrator to look to restructure the company's affairs, sell assets or compromise with creditors. During this period the company can continue to trade while exploring restructuring options that may be available to it.	A formal process whereby a secured creditor appoints a receiver to realise assets subject to their security interest. This process is almost always initiated by a GSA holder such as a bank.	A liquidation is a formal process used where companies have no prospect of being rehabilitated. An insolvent liquidation is the most destructive insolvency process to a business' value and is unlikely to return any value to shareholders. A liquidation is most commonly initiated by a company's shareholders, or by the court on the application of a creditor.
When is this the right process?	— When your company has a **business that has potential future prospects** but is insolvent (either Cash Flow Insolvent or Balance Sheet Insolvent) or is likely to become insolvent. — When your **creditors are likely to commence enforcement action** against you to recover their debt. — When your company **needs breathing space** to formulate/execute a substantive restructuring plan. — If you are **concerned you may be trading while insolvent** or otherwise breaching your duties as a director.	— If you have a **GSA over another company's assets** and they are in breach of their lending covenants you may be able to appoint a receiver over that company's assets. — Or, if **you are in breach of your lending covenants** with a creditor who holds a GSA over your assets and they insist on appointing a receiver over your company.	— When **your company is insolvent** (either Cash Flow Insolvent or Balance Sheet Insolvent) **or could become insolvent** very shortly (and there are not reasonable prospects of the company being able to trade its way out of insolvency). — If you are **concerned you may be insolvent trading** or otherwise breaching your duties as a director. — If **a creditor has applied to have your company placed into liquidation** and you would prefer to control the process and choose the liquidator (you have 10 working days to pass a shareholder resolution appointing your own liquidator after receiving a creditors application to liquidate your company).
What do I need to do?	Discuss your company's financial position with your legal advisor or an insolvency practitioner accredited by Chartered Accountants Australia and New Zealand.		
What is the likely outcome?	A VA will typically result in one of the following outcomes being achieved: — a binding compromise is reached with creditors which is documented by a "deed of company agreement" and control of the company is given back to its directors; or — the company is placed into liquidation.	A receivership will result in repayment of secured creditor debt to the extent that the company's assets can do so. The process is usually terminal to a company and it is unlikely that it will have a business or assets at the end of the receivership (depending on the extent of the security over its assets). It is common for a liquidation to coincide with a receivership.	A liquidation will result in all of the company's assets being realised and the company being removed from the Companies Register.

Key contacts

Reach out to the below contacts if your company is distressed or you are considering a formal insolvency process:

Contact	Description	Details
Official Assignee / Insolvency and Trustee Services (MBIE)	Public insolvency office that can take insolvency practitioner appointments. Primarily useful for smaller businesses.	0508 insolvency https://www.insolvency.govt.nz/support/contact-us/
Restructuring, Insolvency and Turnaround Association New Zealand (**RITANZ**)	Professional body for insolvency practitioners and for those working in business reconstruction, turnaround and insolvency. RITANZ maintains a register of accredited insolvency practitioners that will be suitable for taking insolvency appointments.	https://www.ritanz.org.nz/

For more information visit

kpmg.co.nz
covid19.nzte.govt.nz
investnewzealand.nz

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