Accounting and Finance

MARKET LEADER

Business English

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FT
FINANCIAL TIMES

Contents

UNIT 14

Company insolvency

This unit looks at how a UK company's directors should proceed when their business is experiencing financial difficulties.

BEFORE YOU READ

Discuss these questions.

1 Do you know of any companies which have gone bankrupt in your region or another region you are interested in? Explain what happened.

2 What do you think happens to a company's assets in this situation? What risks can there be for a company's creditors?

When a company is unable to pay its debts and goes out of business, we often say that it has *gone bankrupt*. Officially, in a strict legal sense, this term only applies to individuals in the UK, whereas in the US it can apply to both individuals and companies.

READING

A Understanding the main points

Read the article on the opposite page and answer these questions.

1 What sort of business does the director in this article run?

2 Why is his business experiencing financial difficulties?

3 Which particular problems is he concerned about in relation to his company's current situation?

4 Who is held responsible if a business trades when insolvent?

5 If a company looks like it is going insolvent, who should the directors protect as a first priority?

6 Who should the company directors get advice from if they think they might be going insolvent?

7 What important feature of the company should they also protect?

8 In this situation, what should they also do on a regular basis?

B Understanding details

Read the article again and answer these questions.

1 What three penalties, or 'remedies', could company directors encounter if they trade while insolvent?

2 Which two documents provide information on how company directors should conduct their business?

3 Which financial documents do company directors use to assess the financial health of their company?

4 Besides the company itself, who should company directors take advice for?

5 If they feel that that the company will be unable to repay future debts, which two things must company directors not do?

6 Who should company directors make sure they don't show preference to when experiencing financial difficulties?

7 What specific actions should company directors take during meetings if their company is experiencing financial difficulties?

A responsible approach to insolvency

by Jonathan Moules

Simon Longfield, restructuring partner at Grant Thornton, an accountancy firm, answers the following question about company insolvency.

A **I am a director of a small retail business. My accountant has recently warned me that, following a sharp downturn in trading, the business is unlikely to be able to survive much longer. I am worried about my responsibilities and my financial liabilities if the business becomes insolvent. So what should I be doing right now?**

B As soon as the directors of a company foresee, or even become aware of the possibility of, an administration situation, they need to act carefully to avoid the business trading insolvently, as the penalties for doing this can be severe. These 'remedies' may include personal liability for creditors' debts, disqualification as a company director and, in extreme cases, imprisonment where fraudulent trading has taken place.

C So, as a director, how do you protect the company and yourself from such risks if insolvency is possibly imminent? The principal steps include fulfilling the normal duties expected of a company director, which are set out in the constitution (articles) of the company and the Companies Act. Most importantly, the interests of the company's creditors must become a priority.

D Firstly, the directors must understand the company's current financial situation, assess the prospects for its future viability and act quickly on the position they judge the company to be in. They should use the following information to arrive at a judgement of the company's current position: up-to-date statutory accounts, management accounts and forecasts based on the company's latest order book.

E After that, if the directors decide that their company is moving towards an insolvency position, they need to take independent professional advice from a specialist or licensed insolvency practitioner and, additionally, take advice for themselves personally, if necessary.

F Next, they need to ensure that the assets of the company are always protected and secure and not sold for less than their value. In addition, as well as making sure that they do not take on new supplies or lines of credit that they know the company cannot repay, the directors must be able to show at all times that they are acting in the best interests of all of the company's existing creditors. This last measure is essential to avoid any accusation of special or preferential treatment of specific creditors.

G Finally, directors should hold regular meetings and keep minutes of the discussions they have and the key decisions they make. If there is any doubt about this, they should detail the circumstances that justify continued trading. If they are convinced that the business will be able to 'ride out the storm', then the company and its directors can continue in the normal way.

H However, as soon as they identify that their business is likely to become insolvent, the directors need to act quickly to seek the protection that an insolvency (administration) procedure can offer. It is the job of a licensed insolvency practitioner to help company directors put in place the most suitable procedure – if the business can continue to trade in any way.

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VOCABULARY

A Definitions

1 **Match these words from the article (1–4) with their meanings (a–d).**

1 insolvency	a) when a company which is experiencing financial difficulties is reorganised by an independent specialist with the aim of continuing some of its activities
2 liquidation	b) when a company that is bankrupt is put under the control of an individual by the courts
3 administration	c) when a person or company does not have enough money or assets to pay their debts
4 receivership	d) when a failing company stops operating and its assets are sold to pay its debts

2 **Match each word or phrase from the article (1–8) with one which has a similar meaning (a–h).**

1 small retail business	a) penalties
2 sharp downturn	b) shop
3 financial liabilities	c) big drop
4 remedies	d) intending to deceive
5 disqualification	e) the amount owed to others
6 fraudulent	f) not allowed to continue doing something
7 minutes	g) the place where agreed future sales are recorded
8 order book	h) notes of what is discussed or agreed during a meeting

B Word partnerships

Match the verbs (1–8) with the phrases (a–h) to make expressions similar to those in the article.

1 to take	a) minutes of major discussions and decisions
2 to become	b) independent professional advice
3 to fulfill	c) directors' duties
4 to assess	d) the company's financial situation
5 to understand	e) the prospects for the company's future viability
6 to trade	f) in the best interests of all of the creditors
7 to keep	g) insolvent
8 to act	h) insolvently

C Sentence completion

Use words and phrases from Exercises A and B to complete these sentences.

1 When economic conditions become difficult, businesses can experience a .... in trading.
2 When a company cannot pay its creditors, it becomes ....
3 The company stopped trading, and its assets were sold to pay off its creditors. It went into ....
4 The directors were hiding financial problems in the company, and after an investigation, their dealings were found to be ....

5 As a result, the directors were subject to severe .... They went to prison.

6 In addition to this, they suffered .... as company directors for several years.

7 It was discovered that some important items in their meetings had not been written down in the ....

8 They had also entered false items into their ...., to make their business look more viable than it actually was.

D Understanding expressions

Choose the best explanation for each phrase from the article.

1 'As soon as the directors of a company *foresee* ...' (lines 11–12)

a) predict
b) experience

2 '... if insolvency is possibly *imminent*?' (lines 25–26)

a) going to happen very soon
b) going to happen at some time in the future

3 '... *fulfilling* the normal duties ...' (line 27)

a) increasing
b) carrying out

4 '... must *become a priority*.' (line 32)

a) take first place
b) be ignored

5 '... the prospects for its future *viability* ...' (lines 35–36)

a) realistic existence as a business
b) finding new ways to do business

6 '... will be able to "*ride out the storm*", ...' (lines 73–74)

a) pay as little as possible
b) survive the bad period

OVER TO YOU

1 Can you think of any reasons why companies fail? Think of economies, markets, management, competitors, customers and suppliers. Discuss.

2 If a very large company starts to perform badly and looks like it might fail, what sort of 'spin-off' problems can occur? Think of the national or local economy, the directors, the employees, the customers and suppliers and the creditors. Write a short report detailing your ideas.

3 The following sequencing words and phrases are used in the article to order the steps a company director should take in the case of financial difficulty:

First *After that* *Next* *Additionally* *In addition* *Finally*

Use these to give a short presentation on the subject.