

## ASSESSMENT OF SOLVENCY

### **CURRENTLY, SECTION 56AC OF THE QUEENSLAND BUILDING AND CONSTRUCTION COMMISSION ACT PROVIDES THAT AN INDIVIDUAL OR COMPANY IS EXCLUDED FROM HOLDING A QBCC LICENCE WHEN CERTAIN INSOLVENCY EVENTS OCCUR.**

56AC Excluded individuals and excluded companies

- (1) This section applies to an individual if—
  - (a) the individual takes advantage of the laws of bankruptcy or becomes bankrupt (“relevant bankruptcy event”); and
  - (b) 3 years have not elapsed since the relevant bankruptcy event happened.
- (2) This section also applies to an individual if—
  - (a) a construction company, for the benefit of a creditor—
    - (i) has a provisional liquidator, liquidator, administrator or controller appointed; or
    - (ii) is wound up, or is ordered to be wound up; and
  - (b) 3 years have not elapsed since the event mentioned in paragraph (a)(i) or (ii) (relevant company event) happened; and
  - (c) the individual—
    - (i) was, when the relevant company event happened, a director or secretary of, or an influential person for, the construction company; or
    - (ii) was, within the period of 2 years immediately before the relevant company event happened, a director or secretary of, or an influential person for, the construction company.

### **SUBMISSION TO SATISFY THE COMMISSION OF SOLVENCY**

Under 56AC(4) of the QBCC Act, a person is an “excluded individual” for the relevant company event unless the individual can satisfy the commissioner that at the time the individual ceased to be an influential person, director or secretary for the construction company the company was solvent.

This guidance statement sets out, without limitation, the type of information the QBCC recommends be included in a submission to satisfy the Commission of solvency for the purposes of Section 56AC(4) of the QBCC Act.

The QBCC wish to emphasise the benefit of having an independent expert complete an assessment of solvency for the purposes of satisfying Section 56AC(4) of the QBCC Act, and this is the QBCC’s preferred form of submission for 56AC(4).

When an independent expert report is received by the QBCC, it will be assessed by a qualified accountant to determine if it satisfies the Commission of solvency. If an individual does not wish to have an independent solvency report prepared, or cannot afford to do so, the evidentiary burden remains with the individual to demonstrate solvency at the date they ceased as director, secretary or influential person for the Company (“date of cessation” or “relevant date”).

Accordingly, individuals wishing to demonstrate solvency must prepare a submission based upon appropriate factual evidence and logical argument. It is not the role of the QBCC to identify the relevant information/ data in order to prove solvency, and any submission that is not structured or coherent will not be considered.

The following guidance statement has been prepared to assist you.

### **SOLVENCY DEFINITION**

#### **Statutory Provisions**

Solvency is defined in Section 95A of the *Corporations Act 2001*

Section 95A (1) of the *Corporations Act 2001* states [Solvent person] “A person is solvent if, and only if, the person is able to pay all the persons debts, as and when they become due and payable”.

Section 95A (2) of the *Corporations Act 2001* states [Insolvent person] “A person who is not solvent is insolvent”. The word ‘person’ here is taken to include a company.

### **TWO SOLVENCY TESTS UNDER COMMON LAW**

Under common law it is generally the case that two tests are employed, the cash flow test, and the balance sheet test. The cash-flow test considers the ability of a company to pay its debts (or liquidate assets fast enough to satisfy its debts) as they become due and payable.

The balance-sheet test assesses the solvency of a company by assessing its total external liabilities against the total value of its assets. Where a company’s liabilities are greater than the total sum of its assets, the company is insolvent.

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The QBCC also considers the following 14 indicators of insolvency as relevant to an assessment.

1. Continuing losses;
2. Liquidity ratio below 1 (a ratio of current assets to liabilities)
3. Overdue Commonwealth and State taxes;
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 COD (Cash on Delivery) terms, otherwise demanding special payments before resuming supply;
8. Creditors unpaid outside trading terms;
9. Issuing of post-dated cheques;
10. Dishonoured cheques;
11. Special arrangements with selected creditors;
12. Solicitors' letter, summon(es), judgments or warrants issued against the company;
13. Payments to creditors of rounded figures, which are irreconcilable to specific invoices;
14. Inability to produce timely and accurate financial information to display the company's trading performance and financial position, and make reliable forecasts.

### EVIDENCE TO SATISFY THE QBCC OF SOLVENCY FOR THE PURPOSES OF SECTION 56AC(4)

Based on this understanding of solvency, the QBCC recommends that submissions as to solvency include an examination of cash flows, net assets, and consideration of the 14 insolvency indicators.

The following factual evidence may assist you.

#### A - Evidence of Cash Flows

- 1) Evidence of positive bank balance for 12 months preceding the assessment date (date of cessation).
- 2) Evidence of positive bank balance as at the assessment date.
- 3) Cash flow statements, for most recent reporting periods, demonstrating positive cash flows.

- 4) Confirmation that there were no overdue balances payable to subcontractors, suppliers, or government authorities as at the assessment date.
- 5) Confirmation that there were no dishonoured or withheld cheques.

#### B - Evidence of Net Assets

- 1) Balance sheet, for most recent reporting periods, displaying a positive net asset position and/ or positive current ratio position.
- 2) Profit and loss statement, for most recent reporting periods, confirming profitability.
- 3) Audit or review reports lending credibility to the reported figures.
- 4) Financial records for the date of the assessment.
- 5) Where financial records for the date of the assessment have not been subject to review or audit, it would be relevant to provide a statement from the independent accountant concerning the reliability of the underlying financial data comprising these records, and the basis of reporting. I.e. does the information accrue for known trade debtors and creditors? Tax and other statutory accruals? Amortisation? Bad debts? If a solvency assessment date is mid month, the GL accounts may not include the appropriate portion of month-end accruals.

#### C - Evidence of External Financial Resources

- 1) The courts have found that access to external financial resources is a relevant consideration in assessing solvency. However funds attainable from unsecured borrowings is not to be included when determining solvency.
- 2) It is important that external financial resources appear to have been commercially available to the Company at the relevant date. Consideration of how liquid the resource is, and on what terms could these resources be called by the Company is critical. One should consider if the Company ultimately ceased trading with outstanding tax or other liabilities, and this resource was not made available. This would indicate that the resource may not have been, in fact, commercially available.

#### D - Evidence From Liquidator/ Voluntary Administrator Reports

- 1) Evidence in the liquidator/ voluntary administrators report is highly relevant to any submission of solvency.

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### E - A Timeline of Insolvency Events

- 1) A timeline of the events leading to the date of the appointment of liquidators/ administrators is helpful in determining when insolvency has occurred.
- 2) A statutory declaration from relevant persons may be necessary in order to establish the facts regarding the timing of insolvency events.

### F - Other evidence

Evidence such as the ability to produce timely and accurate financial information, and a good relationship with present bank support an assertion of solvency.

### MATTERS NOT RELEVANT TO SOLVENCY

Some matters are not relevant to the assessment of solvency. For example, character references of the individual subject to exclusion under 56AC(4).

### Important Considerations

In most instances, the following information should be included in your submission to the QBCC for the purpose of satisfying 56AC(4), regardless of whether it supports your submission or not:

- 1) Most recent financial statements to the relevant assessment date – balance sheet, profit and loss, cash flow statement, notes to the financial statement and audit or review reports;
- 2) Bank statements and cash flow information at the assessment date;
- 3) Liquidator's reports ;
- 4) A statement as to whether there were known overdue amounts payable to subcontractors, suppliers or government authorities at the assessment date;
- 5) A statement as to whether the company had secured access to external financial resources at the assessment date and details of the amounts and any limitations;

### GROUP STRUCTURE/ RELATED PARTY CONSIDERATIONS

If the company being assessed is part of a group of companies, the QBCC needs information about the group in order to assess solvency.

In particular the following is necessary to make an appropriate evaluation:

- 1) If the company, or part of the group is a closed group party to a deed of cross guarantee at the assessment date (information on the closed group, and its members)
- 2) Information on related party balances and transactions and whether transactions were on commercial terms.

### QUESTIONS?



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