Early warning signs:

What are those early signs of financial distress and when should you take advice?

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The definition of insolvency:

When is a company technically insolvent in accordance with s123 Insolvency Act 1986?

- The balance sheet test
  - does the value of your liabilities exceed that of your assets?
- The cash flow test
  - can debts and expenses be settled as and when they fall due?
- The legal test
  - have you received a statutory demand and are unable to settle the debt?

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Early warning signs

Signs of financial difficulty

- Build up of inventory (particularly in manufacturing/retail)
- Build up of debtors and creditors
- Inability to pay taxes
- Loss of a major customer
- Borrowing to fund losses
- High staff turnover or loss of key employee(s)
- Lack of current accurate management information
- Withdrawal of or restrictions on banking facilities
- Contractual disputes/legal action
- Lack of cash headroom
- Major impact from change in legislation

A combination of any of these factors can contribute to and worsen financial difficulties.

Whenever there is a risk of insolvency, advice from your trusted advisor or insolvency professional should be taken as early as possible.

Benefits of taking early advice

- **Provides best prospect for survival of the company or business rescue and safeguarding of jobs.**

  Depending on the circumstances, taking early advice from your trusted advisor or insolvency professional may in fact help to avoid failure of a business.

- **Mitigates and potentially avoids personal liability.**

  All directors need to be aware of their statutory duties and need to act in the best interests of the company and its creditors. Amongst other provisions of the Insolvency Act 1986, care should be taken to avoid 'Wrongful Trading' when continuing to trade through financial difficulties. Where continued trading is likely to result in debts increasing and there is a possibility that the company may not return to solvency – professional advice should always be taken.

- **Owner-manager payments can be reviewed.**

  Many directors draw income from a company using a loan account, however an overdrawn balance owed to the company can be a problem in the event of insolvency, following a request for repayment.

Benefits of taking early advice

Ensures all options are considered and an informed decision made

More options are likely to be available if early advice is sought. A formal insolvency option may be the only route available to rescue some or part of the business, time is however a key factor as to what is achievable. Insolvency processes can be put in place very quickly but the prospect of securing a rescue of the business diminishes with time.

Protects suppliers and key relationships

Many businesses rely on trusted relationships which can be severely damaged upon a disorderly failure of a business, as well as the financial impact on supply chains.

Support for a rescue

A managed early engagement with key stakeholders typically provides the best prospect of support being received for a business rescue.

Our Team

Please feel free to reach out to any of the advisory team in our Teesside office who will be happy to provide you with free of charge initial advice

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