

Insolvency and your organisation

Legal information for community organisations

This fact sheet covers:

- what does it mean to be insolvent?
 - your duty to prevent insolvency
 - possible consequences of breaching your duties
 - how to protect against insolvency
 - key warning signs of insolvency
 - what to do if you think you are insolvent or nearing insolvency, and
 - finding insolvency experts.
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This fact sheet provides useful information for incorporated associations and companies limited by guarantee (CLGs) that are facing financial difficulties or are concerned about becoming insolvent.

Not-for-profit community organisations face financial difficulties for a number of reasons. Whatever the cause, your organisation must be aware of the possibility that these financial problems may lead to insolvency, what this means for your organisation and what action to take to remedy the situation before it is too late.

1. What does it mean to be insolvent?

It is often difficult to determine whether an organisation is insolvent just by looking at its financial records and accounts. A range of factors will be relevant.

Insolvency is determined by reference to a 'cash flow test' and not whether (or not) an organisation's assets exceed its liabilities. Under this test, an organisation is insolvent when it is 'unable to pay its debts as and when they become due and payable'.

Insolvency is determined by looking at the financial position of the organisation as a whole. Just because an organisation is lacking money or experiencing an irregular shortage of cash at a particular time, does not necessarily make it insolvent.

An organisation's ability to collect money owed to it, raise funds and sell an organisation's assets (for a reasonable market value in a timely manner) are examples of factors to be considered in determining whether or not an organisation is able to pay its debts when they become due and payable.

CAUTION

Financial problems or insolvency are serious matters. Acting on early warning signs is important. This fact sheet provides general information. If you think your organisation is insolvent, or may be nearing insolvency, you should seek immediate expert advice.



EXAMPLE

In the case of *Sandell v Porter* (1966) 115 CLR 666 the court found that the inability to pay a certain debt does not of itself prove insolvency, but can demonstrate a 'temporal lack of liquidity.' If you are able to obtain the required funds to meet your debt when they fall due by other means, then you may not be insolvent. Your ability to repay a debt is not limited to cash but to other resources such as the sale or mortgage of any security you may have or a pledge of your assets.



2. Your duty to prevent insolvent trading

Incorporated associations and CLGs rely on the actions of their officers. For this reason, committee members of incorporated associations and directors of CLGs have a number of legal duties which they owe to the organisation, including a duty to prevent their organisation from trading while insolvent.

This duty can be split into two parts:

1. to prevent insolvency, and
2. to act diligently and properly if insolvency does occur.

Incorporated associations

The legislation regulating incorporated associations in each state and territory (see the Resources section below) generally sets out the duties of 'office holders' in these associations, which includes a committee member. The four basic duties of office holders are:

- a duty to act in good faith and for a proper purpose:
 - you must act in good faith in the best interests of your organisation, even if this is not in your own best interests, and
 - you must act for a proper purpose, and never take advantage of your position as an office bearer or information you have gained in the role for personal advantage
- a duty to exercise reasonable care, skill and diligence in carrying out the role of a Committee member.
 - you must prevent insolvent trading by the association, which includes the duty not to incur a debt that will cause the association to become insolvent
- a duty not to misuse information or position, and
- a duty to manage conflicts of interest between personal interests and the interests of the organisation.

Committee members of incorporated associations that are registered charities with the ACNC must comply with similar duties (see below).

NOTE

Ignorance is no excuse, and the duty to prevent insolvent trading applies to all committee members and directors. You must not turn a 'blind eye' to the financial status of your organisation, or leave understanding the organisation's finances to the Treasurer and other committee members or directors.



Companies limited by guarantee

The legislation regulating CLGs is the *Corporations Act 2001* (Cth) which includes similar duties to those outlined above. Directors of CLGs that are registered charities with the ACNC must comply with similar duties (see below).

Registered charities

If your organisation is a registered charity with the Australian Charities and Not-For-Profits Commission (**ACNC**), there are duties that apply because your organisation is a charity, including not to allow the charity to operate whilst insolvent.

The *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (the **ACNC Act**) sets out the framework for the registration and regulation of charities. The *Australian Charities Not-for-profits Commission Regulation 2013* (Cth) (the **ACNC Regulation**) was made under the ACNC Act and sets out five 'Governance Standards' that charities must comply with in order to become registered, and remain entitled to be registered under the ACNC Act.

Governance Standard 5 sets out the duties that 'responsible entities' (which include Committee members of incorporated associations and directors of CLGs) must comply with. The duties are largely consistent with those duties described above, including to ensure that the registered charity's financial affairs are managed in a responsible manner and not to allow the registered charity to operate while insolvent.

For further information see the ['Governance for Good' fact sheet](#) on the ACNC website.

RELATED RESOURCES

For more information about the legal duties of committee members and directors, go to our Duties Guide on the Not-for-profit Law Information Hub at www.nfplaw.org.au/governance.



3. Consequences of breaching your duties

Incorporated associations

The legislation governing incorporated associations in each state and territory provides monetary penalties of up to \$40,000 (this differs in each jurisdiction) for breaches of committee members' duties, and in some cases, imprisonment of up to four years (this differs in each jurisdiction).

In cases of insolvent trading, committee members may commit an offence by allowing the organisation to incur debts whilst insolvent. Committee members may then be personally liable (legally responsible) to pay any debts incurred by the organisation or to compensate for any loss which has been suffered.

EXAMPLE OF AN INSOLVENT TRADING PENALTY

The legislation does not distinguish between active or inactive, executive or non-executive directors. If you are a director (committee member of an incorporated association) you can be liable if you continue to trade whilst insolvent and it is unlikely that the debt incurred will be repaid. The courts are strict in their judgment of insolvent trading. In *Tourprint International Pty Ltd v Bott* [1999] NSWSC 571, a director in a small business joined the board of directors within 1 year of the company entering voluntary administration. Despite the small period of time this individual was involved in the company they were held liable to pay over \$500,000.

When facing personal liability for insolvent trading, Committee members may have defences available to them, such as:

- the debt was incurred without the committee member's authority or consent,
- at the time the debt was incurred the Committee member did not have reasonable grounds:
 - to believe that the association was insolvent, or
 - to expect that if the association incurred the debt, it would become insolvent,
- At the time the debt was incurred the Committee member had reasonable grounds to rely on the information provided by a competent person (e.g. accountant and actuaries) about the solvency of the company,
- illness, or
- the Committee member took all reasonable steps to prevent the debt from being incurred.

CAUTION

Committee members and Directors should be careful not to rely on defences. Instead they should always take all reasonable steps to identify the cause of any financial difficulties the organisation is facing, and take action to address them before it is too late

Companies limited by guarantee

There are significant civil (and in some cases criminal) penalties that can apply to directors of CLGs that breach their duties under the *Corporations Act 2001*. Directors can be liable for civil penalty fines of up to \$200,000 and imprisonment for up to five years.

Directors can in some cases, be required to compensate a company for breach of their duties. Further, a court can disqualify directors from managing corporations for a period of time.

RELATED RESOURCES

For general information on insolvency for directors whose companies are in financial difficulty, or are insolvent, and includes information on the most common forms of external administration see Information Sheet 42 on the [ASIC website](#).



Registered charities

Under the Governance Standards, it is the responsibility of the charity, to take reasonable steps to ensure that the relevant people understand and fulfil their duties. For further information, including what steps the charity can take to ensure the duties are understood and fulfilled refer to ACNC Governance Standards Guidance at www.acnc.gov.au.

Where a charity has not taken 'reasonable steps' the ACNC has a number of options to take action including:

- warnings or directions from the ACNC Commissioner compelling compliance,
- additional ongoing oversight and regulation by the ACNC via an enforceable undertaking (which if not complied with may result in court orders to cover losses suffered by the charity or to pay back any benefits gained as a result of the breach of the enforceable undertaking),
- suspension and prohibition of a relevant person from participating in governing the charity (which, if breached could result in both civil and criminal penalties), and
- deregistration of the charity.

Where limits to the ACNC's legal powers mean it cannot use all of the above regulatory options it may seek to refer the charity to other regulators (for example, the state regulator of an incorporated association) under agreements with them with the aim of achieving a consistent approach to all registered charities.

People responsible for managing charities may also face civil or other penalties (for breach of those duties) under other legislation (i.e. state incorporation laws) and under the general law.

RELATED RESOURCES

For more information about the legal duties of committee members and directors, including consequences for breaching these duties, see the Duties page on the Not-for-profit Law Information Hub at www.nfplaw.org.au/governance.



4. How to protect against insolvency

To help prevent against insolvency, Committee members of incorporated associations, Directors of CLGs and 'Responsible entities' of registered charities, should always ensure they comply with their legal duties to:

- act honestly and diligently and in compliance with the organisation's constitution,
- act in the best interests of the organisation,
- not use their position for personal advantage (or for the benefit of a friend or associate), and
- always appropriately disclose conflicts of interests.



TIP

The best approach is to identify the cause of any financial difficulties well before they become a significant problem, and fix them!

This means that they be careful and diligent in managing the financial situation of the organisation. In practice this means they should:

- ensure they are kept up-to-date on the financial circumstances of the organisation at all times (ie debts owed and cash flow),
- prevent the organisation from incurring debts when there are reasonable grounds to suspect it will be unable to repay them, and
- identify problems the organisation may have (including its expenses and liabilities, and income and cash flow) and putting in place mechanisms to mitigate those problems.

It is important that the advice of an expert accountant or financial advisor is obtained at the first sign of trouble. A list of financial advisors and institutions are below.

5. Key warning signs of insolvency

Any of the following factors are relevant in determining when an organisation is insolvent or nearing insolvency:

- continuing losses over successive financial reporting periods
- overdue tax debts, for example 'pay-as-you-go' (PAYG) instalments, GST, and superannuation guarantee contributions
- increasing levels of bad or doubtful debts, the collapse of a significant creditor or withdrawal of a major source of funding
- inability to borrow funds or get loan approvals

- cheques issued by the organisation being returned dishonoured, cheques being issued post-dated (that is, dated after the date on which it is actually written), or are not being sent
- delays in paying suppliers resulting in stricter credit terms or suppliers insisting on “cash on delivery”
- payment of creditors outside trading terms
- payment of creditors of rounded sums which are not reconcilable to specific invoices
- legal proceedings being initiated or threatened by creditors, including the Australian Taxation Office (ATO), or judgments being entered against the organisation, and
- inability to produce timely and accurate information on the organisation’s performance and financial position.

Note this is not an exhaustive list of there are a range of factors which may ultimately point to the company’s inability to pay their debts when they fall due.

CAUTION

If legal proceedings are threatened or initiated by creditors (including the ATO) it is important that you do not ignore them! This is because the court may make an order placing your organisation into the hands of liquidator in your absence. If you are aware of legal proceedings being commenced against your organisation seek urgent legal advice.



NOTE

Cash flow means cash received by the organisation minus cash paid over a given period of time; movement of cash in and out of an organisation over a given period of time.

Creditor means a person, company or other organisation that your organisation owes money to. For example: paid staff of the organisation are creditors if they are owed wages, the landlord may be a creditor if owed rent.

Debt means an amount owed by your organisation to a person, company or another organisation.

Debtor means a person, company or other organisation that owes money to your organisation. For example: a person your organisation provided a service to in exchange for a fee, which has not been paid.

Administrator means people with specialist accounting training who are appointed to an organisation that is in or close to insolvency, to administer that organisation’s affairs. Depending on the circumstances, the purpose of an appointment is usually to recover debts owed to creditors (to the extent possible) and, where there is no prospect of rescue, bring the organisation to an end.

Voluntary administration means the company directors have chosen to appoint a voluntary administrator (i.e. liquidator) to investigate the company’s affairs and will recommend whether the company should go into liquidation, enter a deed of company arrangement or return the company to the control of the directors. This process often occurs when a company is, or is likely to become, insolvent.

Liquidation means a company will be wound up and the sale proceeds will first be distributed amongst its creditors to repay any debts, with any remaining surplus going to the shareholders. There are three types of liquidation: member’s voluntary administration, creditor’s voluntary administration or by a court order.



6. What should we do if our organisation is facing insolvency?

If your organisation is experiencing any of the above factors you need to take immediate action, to prevent insolvency or to prevent the organisation from continuing to trade while insolvent.

You should speak with the organisation's accountant or discuss the concerns with the organisation's auditor (if any) or another accountant who can help assess the financial position of the organisation. You should also consider doing any or all of those things set out below (What can you do?). If there is any doubt any of these options will not provide a quick turnaround more drastic action may be required in the interests of the organisation, its members and its creditors.

An independent qualified accountant who has looked at the financial position of the organisation will be best placed to advise you on your options (some of which may be on the list below) and may include appointing a liquidator or other external administrator. See the links below on how to find insolvency experts.



TIP

Acting early and getting expert advice can be the difference between your organisation surviving or not.

What can you do?

First and foremost seek expert financial or legal advice. They may provide you with options that are most suited to your individual situation. Examples may include:

- reduce expenses and liabilities, for example, review options for cost cutting, including reducing employee costs,
- increase income and cash flow by:
 - call in any outstanding debts or fees owed to the organisation
 - seeking financial assistance from members
 - investigating alternative sources of income
 - approaching banks or other lenders for a loan (providing that the organisation will have sufficient income in the future to make repayments as and when they fall due), and
 - seeking financial assistance from the community, including through fundraising appeals
- negotiate a payment plan with the ATO if there are outstanding tax or superannuation guarantee contribution debts, and
- negotiate a payment plan with creditors including banks.

7. How to find insolvency experts

Accountants

To find an expert accountant or financial advisor with insolvency experience you should contact:

- [Chartered Practising Accountants Australia](#)

- [Institute of Chartered Accountants](#)
- [Institute of Public Accountants](#), or
- [Australian Restructuring Insolvency & Turnaround Association](#).

TIPS

When engaging an accountant or financial advisor:

- ask for a recommendation of a person or firm that has experience dealing with not-for-profit organisations.
- ask for a guide as to the fees they are likely to charge your organisation, and
- if your organisation is small and/or run by volunteers – ask if the accountant/auditor has reduced fee arrangements.

Lawyers

To find a lawyer who has experience in insolvency law, contact the following services in your state or territory:

- Law Institute of Victoria (LIV) – [Legal Referral Service](#)
- Law Society of NSW – [Solicitor Referral Service](#)
- Queensland Law Society – [Find your Solicitor](#)
- Law Society of Western Australia – [Find a Lawyer](#)
- Law Society of South Australia – [Legal Referral Service](#)
- Law Society Northern Territory – [Legal Referral Service](#)
- ACT Law Society – [Find a Lawyer](#)
- Law Society of Tasmania – [Search for a lawyer](#)

TIP

Most firms on the referral databases are private law firms – this means they charge normal solicitor fees. Be sure to ask about their fees before you meet with them for your first appointment!

Resources

Related Not-for-profit Law Resources

The Not-for-profit Law Information Hub at www.nfplaw.org.au has further resources on related topics:

✔ The incorporation decision – www.nfplaw.org.au/incorporationdecision

This page explains the legal consequences for your organisation in deciding whether or not to incorporate.

✔ Choosing a legal structure – www.nfplaw.org.au/legalstructure

This page outlines the main options available for each kind of incorporated structure.

✔ Governance – www.nfplaw.org.au/governance

The Governance page covers the roles and legal duties of boards, committees and office holders.

✔ Fundraising – www.nfplaw.org.au/fundraising

This page helps charities and not-for-profits navigate Australia's tricky fundraising laws.

✔ Insurance and risk – www.nfplaw.org.au/riskinsurance

This section of the Information Hub covers insurance, background checks, negligence, work healthy and safety, Personal Property Securities Register and criminal conduct.

Legislation

✔ [Associations Incorporation Reform Act 2012 \(Vic\)](#)

✔ [Associations Incorporation Reform Regulations 2012 \(Vic\)](#)

✔ [Associations Incorporation Act 2009 \(NSW\)](#)

✔ [Associations Incorporation Regulation 2010 \(NSW\)](#)

✔ [Associations Incorporation Act 1981 \(Qld\)](#)

✔ [Associations Incorporation Regulation 1999 \(Qld\)](#)

✔ [Associations Incorporation Act 2015 \(WA\)](#)

✔ [Associations Incorporation Regulation 2016 \(WA\)](#)

✔ [Associations Incorporation Act 1985 \(SA\)](#)

✔ [Associations Incorporation Regulations 2008 \(SA\)](#)

✔ [Associations Act \(NT\)](#)

✔ [Associations Regulations \(NT\)](#)

✔ [Associations Incorporation Act 1991 \(ACT\)](#)

✔ [Associations Incorporation Regulation 1991 \(ACT\)](#)

✔ [Associations Incorporation Act 1964 \(Tas\)](#)

✔ [Associations Incorporation Regulations 2007 \(Tas\)](#)

✔ [Corporations Act 2001 \(Cth\)](#)

This legislation regulates all not-for-profit companies limited by guarantee.

✔ [Australian Charities and Not-for-profits Commission Act 2012 \(Cth\)](#)

This legislation regulates all registered charities for the purposes of Commonwealth law, no matter what legal structure the charity has.

Regulators of incorporated associations

✔ [VIC - Consumer Affairs Victoria](#)

✔ [NSW - NSW Office of Fair Trading](#)

✔ [QLD - Office of Fair Trading](#)

✔ [WA - Consumer Protection WA](#)

✔ [SA - Consumer and Business Services](#)

✔ [NT - Licensing NT](#)

✔ [ACT - Access Canberra](#)

✔ TAS – Consumer Affairs and Fair Trading

Other Resources

✔ [Australian Charities and Not-for-Profits Commission](#)

Provides further information on registered charities and their obligations under the ACNC Act.

✔ [Australian Taxation Office](#)

Responsible for administering taxation laws for the Commonwealth Government.

Provides further information on registered charities and their obligations under the ACNC Act.

✔ [Australian Securities and Investment Commission](#)

Responsible for administering the *Corporations Act 2001*.

A Not-for-profit Law Information Hub resource. Access more resources at www.nfplaw.org.au

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