Is My Company Insolvent?

With high interest rates and rampant inflation, it's important for businesses to take stock of their financial situation and address early triggers before they morph into bigger problems. In a series tailored specifically to business owners, Allan Nackan starts with one of the most common questions we receive—*is my company insolvent?*

The answer to this question is determined by simple mathematics. If your company is either unable or unwilling to meet its liabilities as they become due—or the net realizable value of your company's assets (property, inventory, equipment, accounts receivable etc.) is not sufficient to enable payment of all its liabilities—then your company is insolvent.

While many companies are often technically insolvent based on the latter asset-based test, the former cash-flow-based test is often an indication of serious underlying issues.

Cash flow difficulties can snowball to something unmanageable if not detected, triaged, and treated in a timely manner. Circumstances that may seem unimportant at the time, such as paying a supplier late or falling behind on a tax remittance, must be tracked and addressed to avoid future problems.

While not all debts of your company automatically become your personal obligation as a director, you are acting in a fiduciary capacity—meaning that you should be treating the company as if its interests were your own personal interests—and you may have actual personal liability for certain company's debts, including: where you have signed personal guarantees to banks, landlords or other parties or if your company is in arrears for government remittances and certain payroll-related obligations.

While there can be events that are clearly catastrophic to the solvency and viability of a company, directors of a company should be diligent and heed the softer warning signs to ensure that they are equipped to handle a gradual decline. In either case, it is recommended that directors take a proactive approach by consulting with a Licensed Insolvency Trustee (LIT) to review options and identify the best path forward. Earlier action provides the greatest opportunity to take remedial action and manage or hold off more catastrophic financial consequences.

LITs are specifically trained to assist directors and other stakeholders through financial trouble. In addition, they are licensed by the Office of the Superintendent of Bankruptcy, an agency of the federal government, to oversee and implement formal insolvency and restructuring proceedings where warranted and to provide proactive advice to avoid an insolvency filing.

Below is a list of formal insolvency proceedings along with some warning signs that your business might be exhibiting:

List of Formal Insolvency Proceedings

- restructuring under the *Companies Creditors Arrangement Act* (“CCAA”)
- proposal to creditors under the *Bankruptcy and Insolvency Act* (“BIA”)
- bankruptcy
- receivership
- recognition of foreign insolvency proceedings under CCA or BIA

Early Triggers

- cash-flow problems and challenges
- exploring cost-cutting measures
- extending payment terms for suppliers
- increasing credit facility or overdraft limit
- actively looking for new capital
- putting your own money into the business
- acquiring new shareholder advances
- loss of customers or key contracts ending
- industry downturns (i.e., retail, automotive, or manufacturing declines)
- political or environmental effects (i.e., steel tariffs and interest rate fluctuations)

Concerns

- your bank moves your account into its special loans group and is insisting on a higher degree of oversight, which may include appointing a consultant or monitor

- inability to keep current with government remittances; in effect, borrowing from the Canada Revenue Agency ("CRA")—non-payment of GST/HST, corporate tax, payroll taxes
- breakdown in accounting systems resulting in delays in preparing financial statements and late filing of tax returns
- loss of key personnel—death or sudden departure of CFO
- issuing personal guarantees for corporate loans
- avoiding calls and letters
- work stress permeating home life
- inability to make payroll
- falling behind on rent
- bad debts related to large accounts which negatively impact your current and future cash flow and viability (i.e., if a major customer files for bankruptcy)
- inability to finance projects or maintain production
- relying extensively on alternative, more expensive forms of financing such as account factoring

Serious Problems

- threat of legal action or receipt of Statement of Claim
- lender has issued demand as a prelude to enforcement
- forbearance arrangements with lenders
- landlord threatens to terminate lease or distrain on assets in the premises
- creditor pressure
- bank calling the company's loan or capping credit availability
- receiving a *Notice of Intention to Enforce Security* from a secured creditor
- suppliers' discontinue supply or service
- large and looming director or shareholder advances
- fraud and misappropriation
- shareholder disputes

Solving Cash Flow Problems During Uncertainty

Is negative cash flow hampering your business? Read article

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