



RAPSEY GRIFFITHS

TURNAROUND + INSOLVENCY

Tracker



% Income Per Product



Total Sold	Total Revenue	Shipping Charge/Item	Shipping Cost/Item	Profit per Item (incl. shipping)	Returns	Total Income
15	\$300.00	\$10.00	\$5.75	\$14.25	2	\$196.75
18	\$362.25	\$10.00	\$5.75	\$12.88	1	\$224.63
20	\$429.00	\$10.00	\$6.25	\$12.20	0	\$244.00
25	\$475.00	\$5.00	\$3.50	\$6.00	0	\$300.00
30	\$319.20	\$5.00	\$3.25	\$5.35	3	
1,885.45						

INSOLVENCY IN

BUILDING AND CONSTRUCTION

A 101 guide for directors of building and construction companies

Contents

Introduction	1
Chapter 1: Insolvency explained	2
Chapter 2: Managing insolvency risks	4
Chapter 3: Understanding directors' duties	7
Chapter 4: Tackling insolvency: First steps	9
Chapter 5: Tackling insolvency: Formal appointments	10
Chapter 6: Case studies	12
Additional resources	16

This e-book is designed to help directors of building and construction companies, including general contractors, renovation contractors, owner-builders and real-estate developers.

INTRODUCTION

The construction game can be tough. If you're operating in the industry, you're at potentially higher risk of facing insolvency, and you could become the victim of insolvency higher up the chain. However, with the right advice and actions, you can minimise the risks.

Where do these risks come from? Firstly, from property market conditions where work levels ebb and flow in line with demand. Secondly, from a culture of underbidding, which squeezes those both at the top and bottom of the chain, with contractors and subbies coming off worse.

On top of this, your building and construction businesses can suffer financial distress for more specific reasons. For example, you may have made a mistake in estimation, or have a contract that's run out of money due to subcontractor delays.

The outcome? You go from a sure profit to a small profit to a loss. If you are unable to meet this loss and improve your cash flow, you can become financially unstuck. From here, the prospect of insolvency grows brick by brick in front of you.

In this e-book, we take a comprehensive look at insolvency in the construction industry and offer our advice on how to avoid and manage it. We cover all the key questions including: What are the warning signs to look out for? How can I reduce the risks? What are my legal obligations? And, what actions do I need to take when things go wrong?

1,700

cases of insolvency in the construction industry nationwide every year

20-25%

cases of all insolvencies in Australia are in the construction industry

CHAPTER 1 INSOLVENCY EXPLAINED

Financial ups and downs are par for the course in the construction industry, and, unfortunately, insolvency is an ongoing and prevalent issue. But, what exactly is insolvency and what are the vital warning signs to look out for?

WHAT IS INSOLVENCY?

Insolvency is the state of being insolvent or unable to pay your debts as and when they are due and payable. If you're facing it, it's a daunting reality.

KEY WARNING SIGNS

Determining insolvency isn't always easy. A forward-looking **cash flow test** can help you determine your company's ability to pay its debts when they become payable. However, you also need to look at your wider financial position.

- (1) A person (or company) is solvent if, and only if, the person (or company) is able to pay all the person's debts as and when they become due and payable."
- (2) A person (or company) who is not solvent is insolvent
—Section 95A of the Corporations Act 2001 (Cth) (the Act).

It's important to note the difference between a temporary lack of liquidity (you may still be solvent) and an endemic shortage of working capital. To figure out which applies to your company, you can use a balance sheet test.

INSOLVENCY INDICATORS

- Continued losses over successive financial reporting periods
- Inability to borrow money or obtain loan approvals
- Overdue taxes
- Poor liquidity ratios
- Inability to produce timely and accurate information on your company's performance and financial position
- Dishonoured and post-dated cheques
- Special arrangements with certain creditors and suppliers, for example a payment plan

If your construction business is facing any of the above, you should take immediate action. (See Chapters 4 & 5).

It's important to note the difference between a temporary lack of liquidity (you may still be solvent) and an endemic shortage of working capital. To figure out which applies to your company, you can use a **balance sheet test**.

CASH FLOW TEST

A cash flow test looks at whether your company can pay its liabilities, and when they fall due. Because lengthy payment terms are typical in the construction industry due to the nature of big projects, these should be taken into account.

BALANCE SHEET TEST

A balance sheet test involves looking at your balance sheet to work out whether your company would have more assets or liabilities if it were immediately wound up. In the construction industry, work-in-progress (WIP) is considered an asset.

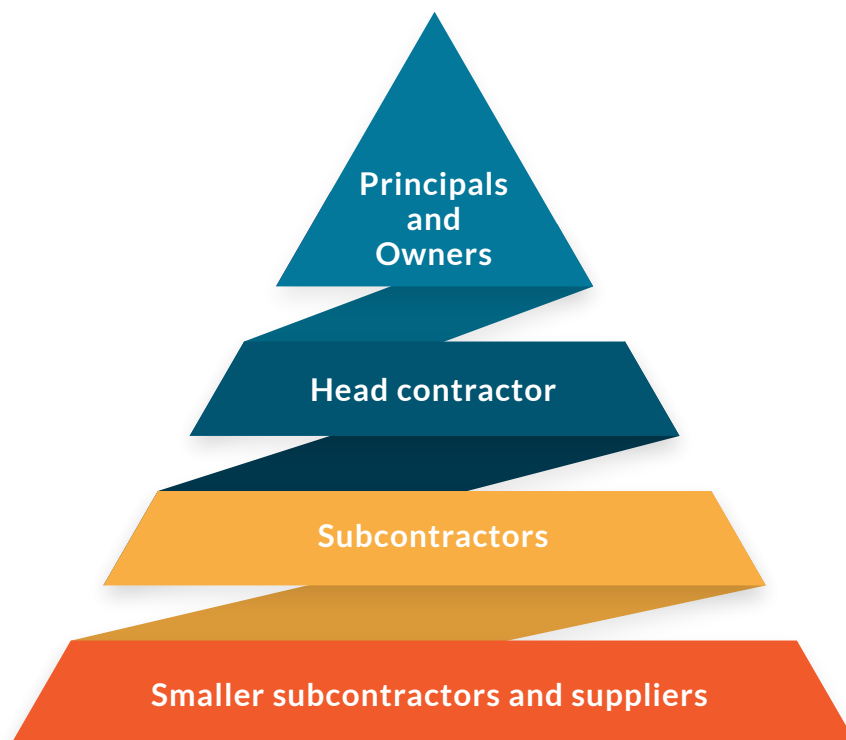
Common causes of insolvency in construction

- **Project lag** – committing to a project when the economy is good only for the project to lag for another two years.
- **Cash flow issues** – including late payment and bad debt.
- **Lack of profitability** – the process of winning work is highly competitive and price sensitive. In many cases, the only way to win a contract is to charge the lowest price.
- **Frequency with which suppliers and clients go out of business.**
- **Availability and cost of credit.**

CHAPTER 2 MANAGING INSOLVENCY RISKS

Staying solvent in the construction industry can be tough. Part of the problem is how you manage your business and cash flow. However, it's also down to the structure and tumultuous nature of the industry itself. The solution is curbing the risk.

UNDERSTANDING THE CONSTRUCTION PYRAMID



If you are a subcontractor performing most of the work, you don't have a direct contractual relationship with the principal for whom the works are being done and who is ultimately financing the project. This power balance means failures up the top cascade down, increasing your risk of insolvency.

If despite your best efforts to curb the risk your building or construction business is facing insolvency, the next step is making sure that you understand your legal obligations.

MANAGING THE IMPACT OF INSOLVENCY

Getting your contract right will help ensure potential insolvency risks of companies either above or below you in the pyramid are sufficiently managed. It will also lessen your company's liability where unexpected events affect a project. Here are some things to cover:

- Clearly and correctly identify who each party is to the contract (for example, with their registered business entity and ABN).
- Outline the key roles and responsibilities for each party to the contract, and make sure they are enforceable obligations.
- Ensuring that each party to the contract is only taking on risk that it controls and where it does not control the risk, is properly able to obtain insurance to manage that risk.
- Establish ownership of materials brought to site and ensure those materials are not unlawfully removed.
- A clear programme with appropriate mechanisms for managing, and if necessary, extending time for delivery.
- Clarify the right to terminate or suspend work in the event of insolvency or suspected insolvency.
- In the event of termination, incorporate a clause enabling the retention of future contractual rights.
- Clearly identifying what is required for completion of the works, or practical completion under the project and that those requirements can be met.

IF YOU ARE PRINCIPAL OF A CONSTRUCTION PROJECT:

- Register an interest on the Personal Property Securities Register (PPSR) to gain priority in the event of insolvency.
- Obtain appropriate security and insurances from the contractor.
- Incorporate proof of payments to subcontractors and sub-subcontractors as a pre-condition for progress payments.
- Only allow for the payment of materials or goods not incorporated into the works in very limited circumstances, and in those circumstances ensure there is a PPSR registration.
- Where appropriate, include provisions to allow an audit of the contractor to ensure that payments are being made.
- Have clear rights of suspension and termination in the event of non-performance by a contractor.
- Demand the novation of subcontractors to enable you to step into the shoes of the insolvent contractor and have its subcontractors complete their works.

IF YOU ARE A HEAD CONTRACTOR:

- Obtain appropriate security and insurances from subcontractors and suppliers.
- Ensure that the risks taken under the head contract, including any design requirements or obligations around completion, can be met and properly managed.
- Take advantage of your right to suspend work under the contract for non-payment.
- Include clauses in your contracts to protect ownership of materials and equipment.
- Register security interests on the PPSR so they are enforceable in the case of insolvency.
- Keep accurate records of all your communications, including verbal.
- Take action on late payments, lodge all claims promptly; and lodge a charge or notice of claim for a debt or lien to gain priority in the event of insolvency.

IF YOU ARE A SUBCONTRACTOR OR SUPPLIER:

- Get personal guarantees where credit is provided.
- Gain security over the company's assets.
- Take advantage of your right to suspend work under the contract for non-payment.
- Include clauses in your contracts to protect ownership of materials and equipment.
- Register security interests on the PPSR so they are enforceable in the case of insolvency.
- Keep accurate records of all your communications, including verbal.
- Take action on late payments, lodge all claims promptly; and lodge a charge or notice of claim for a debt or lien to gain priority in the event of insolvency.

ADDITIONAL ACTIONS TO TAKE:

- Prior to entering into any contract, carry out ASIC director and related party searches on contractors to look for wind up documents, or company name changes – a sign of phoenix activity.
- Make sure bank guarantees for completed projects are returned in line with the contract.
- Carry out a PPSR search to identify the extent to which businesses are engaging new suppliers and not paying previous ones.
- Review your business structures/ finances to identify security or guarantees provided to support loans, and how funds can be accessed if cashflow dries up.
- Properly and fully review any contract before entering the contract, including all general terms and the scope of works.



CHAPTER 3 UNDERSTANDING DIRECTORS' DUTIES

Under insolvency law, directors of companies are bound by a series of statutory, common law and equitable obligations owed primarily to the company that employs them. These are called directors' duties. So, what are yours?

Who is a director?
The definition of 'director' under the Act includes shadow and de facto directors or any alternate director that is appointed and acts in that capacity.

COMMON LAW DUTIES

Under common law, directors have a duty to:

- act in good faith and the best interests of the company;
- act with care and diligence;
- avoid conflicts of interest and;
- not improperly use company information.

If you allow your company to get into financial hot water or realise it's insolvent or facing insolvency and fail to act, you are failing to meet these duties.

THE CORPORATIONS ACT 2001 (THE ACT)

The common law duties are reinforced in the Corporations Act 2001 (the Act), which includes a duty to act with care and diligence (section 180 (2)) and in good faith, and a requirement for directors to not improperly use their position or information.

KEEP YOUR RECORDS IN CHECK

One of your specific duties under the Act is a duty to ensure that your business keeps adequate books and records. These must correctly record and explain your company's financial position and performance. Include work-in-progress reports (WIP).

Consequences of breaches of duty

- Civil penalties of up to \$200,000 (where there were reasonable grounds the director suspected insolvency and failed to act)
- Compensation proceedings for amounts lost
- Criminal charges of up to \$220,000 or imprisonment for up to 5 years, or both (where the director suspected insolvency and failed to act)
- Disqualification from managing a corporation

SECTION 588G – DUTY TO SOLVENCY

Under Section 588G of the Act, directors have a duty to prevent insolvent trading where:

- they were director at the time the company incurred the debt, and
 - the company was insolvent at that time, or became insolvent by incurring a debt; and
 - at that time there were reasonable grounds for suspecting the company was insolvent or would become insolvent.
- Further provisions relating to insolvency are contained in Sections 588H-Z.

AVAILABLE DEFENCES

As director, you have several defences open to you. These include reasonable grounds to expect solvency, reasonable reliance on information provided by others, absence from management, and reasonable steps to prevent incurring of debt (s).

However, these shouldn't be relied on. Instead, you should take reasonable steps to identify the causes of your financial difficulties and take action prior to any breach occurring.



CHAPTER 4

TACKLING INSOLVENCY: FIRST STEPS

If your construction business is financially crumbling, you need to be proactive and act fast to ensure that you cannot be held liable for insolvent trading and a breach of your directors' duties. But what are the first steps you need to take?

FIRST STEPS

- Thoroughly investigate your financial difficulties.
- Keep accurate records and stay informed on your company's financial situation.
- Seek advice from a qualified expert, e.g., an accountant, to determine your position.

Entering 'Safe harbour'

Under Section 588GA of the Corporations Act 2001 (the Act), if you are taking actions to improve your financial situation, you can access 'safe harbour' protection.

This provides a defence from insolvent trading liability if the courses of action taken are reasonably likely to lead to a better outcome, and your tax and super obligations are met.

The ipso facto clause

The ipso facto insolvency reforms, effective from July 1, 2018, prevent a party from exercising a right under a contract, agreement or arrangement that arises due to a formal insolvency restructuring including VA, receivership of a scheme of arrangement. This includes a right to terminate your contract.

INFORMAL TURNAROUND

If there are concerns for solvency, but your company is still considered financially viable, you can start developing and actioning a plan to turn things around.

Every situation is different so will require different strategies. You might look at improving efficiencies and rationalising resources, such as negotiating temporary relaxed payment terms with creditors. Or you may need to downsize and make redundancies.

Importantly, these courses of action should be properly recorded. This includes having a **written turnaround plan**, a business review document, and advice prepared by an expert.

In the building and construction game, you may not have physical assets to sell to meet short term demands, so cash flow management is key. Once you start having cash flow issues, the knock-on effect is reluctant subcontractors with inflated prices.



CHAPTER 5

TACKLING INSOLVENCY: FORMAL APPOINTMENTS

If your company is already insolvent and a turnaround plan is not viable, your next move is a formal insolvency appointment. For this, you should engage reputable and qualified experts registered with ASIC and ARITA to assist you.

FORMAL INSOLVENCY APPOINTMENTS

VOLUNTARY ADMINISTRATION

During the voluntary administration process, an independent administrator is appointed by the director to take over, assess all options, draw up a DOCA, and generate the best possible outcome for your creditors. The process typically takes 25 business days.

PUBLIC REPUTATION

As formal insolvency appointments are typically made public, you may be concerned about the negative impact this will have on your business, e.g., contract terminations. However, by avoiding a formal insolvency appointment, you can make the situation worse, including breaching your obligations under the Act.

What is a DOCA?

A Deed of Company Arrangement (DOCA) is a binding arrangement between a company and its creditors governing how its affairs will be dealt with. It maximises the chances of a company continuing while providing a better return for creditors than winding up. ([ASIC](#))

LIQUIDATION

Liquidation is usually considered the last resort but offers a more conclusive outcome. If your company goes into liquidation, it's ultimately because it can't pay your debts or you want to wind things up.

During liquidation, control is handed to the liquidator. The process involves selling off your assets, winding up your financial affairs, breaking up the company structure, then figuring out what happened. In addition, bank accounts are frozen and employment terminated.

RECEIVERSHIP

Receivership in the construction industry is unusual. This is because companies rarely have tangible assets that can be released. Financiers, in particular banks, are also unlikely to appoint a receiver because they want to protect their reputation.

KEY CONSIDERATIONS

In a formal insolvency appointment, the administrator or liquidator will consider the following industry-specific issues, including the impact on contracts, bank guarantees, set-off, home warranty (residential), insurances and environmental and WHS.

How do I pay laid off staff?

If there is not enough money to pay your employees their entitlements, they can ask for help via the [Fair Work Ombudsman](#) and the [Fair Entitlements Guarantee](#). Entitlements include unpaid wages, annual leave, long service leave, and redundancy pay.

CHAPTER 6

CASE STUDIES

We deal with many construction clients – big and small – who are facing financial difficulties and insolvency.

The solutions we deliver are highly-tailored to the business and circumstances. Here are three real-life situations we helped resolve.

CASE STUDY 1 – SAFE HARBOUR & TURNAROUND

BACKGROUND

A large residential construction firm had been on an aggressive growth path leading up to economic slowdown in the local area. Combined with headwinds and the existing market forces at play, this led to a cash flow crisis. We were called in to review the company's situation and determine the most appropriate response to its circumstances.

CORE PROBLEM

To avoid downsizing the business, the directors attempted to diversify and enter into a development agreement with landowners to share in the proceeds once the houses were sold. This tied up a significant proportion of the company's working capital and was preventing it from starting new projects as a result of Home Owners Warranty (HOW) restrictions.

THE SOLUTION

After assessing the business' viability, we advised a business stabilisation/turnaround plan and that they triggered safe harbour protection. Our role in implementing the plan involved:

- Determining current labour requirements and making cuts where needed.
- Assisting with negotiations to exit the loss-making construction contracts.
- Identifying non-core assets and arranging a sale to pay down bank debt and assist the working capital shortfall.
- Negotiating a standstill agreement with the

major financiers and assisting the CFO in negotiating a repayment plan for the ATO and other key suppliers.

- Recommending changes to the management team and structure.
- Eliminating unprofitable lines of business and unnecessary capital expenditure.
- Improving their accounts receivable collection process.

THE OUTCOME

- As a result of accessing safe harbour and implementing the turnaround plan:
- The cash flow crisis was able to be managed appropriately.
- Stakeholder relationships were restored with confidence and integrity.
- The business was able to continue to trade and avoided a formal insolvency appointment.
- Creditors were repaid in full, and the majority of employees remained employed. Staff that were made redundant were paid in full, and shareholder value was preserved.
- The business's economic value was stabilised.

The business slowly returned to profitability. In addition, the strategic focus shifted from cashflow to profitability and return-on-equity, and on economic value-add

“The key in any turnaround is to take action early. In this case, as in all cases, we worked with the business, its advisors, and its stakeholders to develop solutions in challenging and difficult situations with a positive end result.”

CHAD RAPSEY (CO-FOUNDER/DIRECTOR)

CASE STUDY 2 – VOLUNTARY ADMINISTRATION

BACKGROUND

A small business group specialising in the repair, maintenance, and installation of automatic sprinkler and other fire protection systems for commercial premises got into financial difficulty after the first two years of trading. We were called in as voluntary administrators (VAs), taking control of their business and cashflow for two months.

CORE PROBLEM

The group faced financial difficulty primarily due to aggressive unstructured growth (from \$0-\$2m in two years) without the right controls in place. The directors had also received poor business advice. The result was approx \$1.4m of ATO/OSR debt, difficulties in reconciliation, an unsecured debt position too high to trade out of, and no access to equity.

THE SOLUTION

Working as voluntary administrators, we proposed the following solution:

- The implementation of a holistic business turnaround strategy alongside the newly appointed company accountant.
- An independent review into the business's projected trade profitability and cashflow to verify viability.
- Formulation of a deed of company arrangement (DOCA) between the company and creditors to satisfy the business's existing debts.

THE OUTCOME

The creditors accepted the proposal set out in the DOCA, which led to them receiving greater returns than liquidation. Additional benefits of the acceptance of the DOCA included:

- Monthly monitoring and compliance reporting assistance to ensure continued viability.
- Maintenance of all further tax and employee obligations.
- Avoidance of complexities associated with the group structure.
- Avoidance of a court application to appoint a receiver over the trust business assets.
- Estimated intra-group and related party claims removed from the creditor pool.
- Employee job retention avoiding the crystallisation of employee entitlements and redundancies.
- Employee received 100% of the employee entitlements.
- Unsecured creditors received a return of 19c /\$.
- The Company's debts were reduced by approximate \$1.134 million.

As a result of completing this voluntary administration turnaround alongside the new accountant and directors, the group is continuing to trade profitably.

“Using our expertise, we were able to simplify a complex problem and focused on the best outcome for the business. Working in collaboration with the business owners, their accountant, and legal team, we were able to achieve a fantastic result for employees, creditors, and shareholders.”

CHAD RAPSEY (CO-FOUNDER/DIRECTOR)

CASE STUDY 3 – VOLUNTARY LIQUIDATION

BACKGROUND

A medium-sized construction company specialising in residential property construction found itself in financial difficulty due to a range of internal and external factors, including defective work claims. We were called in to review the company's particulars and identify the most appropriate response to its challenges.

CORE PROBLEM

Following a business viability review, we determined that the company was insolvent and unable to continue trading. As the owners and managers were experiencing high levels of stress and the business was lacking the capacity to undertake a turnaround strategy, we needed to provide a way for the company, its stakeholders and its creditors to move forward.

THE SOLUTION

Given the company's inability to pay its significant debts as and when they fell due, we determined the best solution would involve:

- Entering creditors' voluntary liquidation (also known as business liquidation).
- Establishing and realising the assets of the company.
- Communicating with employees and creditors regarding the liquidation process.
- The liquidator dealing with incomplete construction projects and assisting customer claims under the home building compensation scheme.

THE OUTCOME

While liquidation is generally a last resort, the benefits of undertaking the creditors' voluntary liquidation reduced the risk of insolvent trading and ended the defective work claims. It also:

- Averted a standard director penalty notice (DPN) being issued by the ATO (subject to lodgements being made on time).
- Enabled employment entitlements to be paid in full via the Fair Entitlements Guarantee (FEG) scheme.
- Saw employee superannuation paid from the assets realised by the liquidator.
- Allowed customers to have their projects completed by an alternate construction company.
- Resulted in unsecured creditors receiving a distribution of 10c /\$.
- Unsecured creditors wrote off debts of approximately \$840,000.

The liquidation helped the directors to comply with their duties, providing employees and creditors with a return on outstanding debts.

“Clarity makes resolution easier to achieve. By working together, we can put mechanisms and processes in place that help move things towards a suitable outcome.”

MITCH GRIFFITHS (CO-FOUNDER/DIRECTOR)

ADDITIONAL RESOURCES

Insolvent Trading | Australian Institute of Company Directors

https://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/director-tools/pdf/05446-6-3-duties-directors_insolvent-trading_a4-web.ashx

Building & Construction Industry Fact Sheet | GOV

<https://www.business.gov.au/planning/templates-and-tools/industry-factsheets/building-and-construction-industry-fact-sheet>

Types of building and construction businesses | ATO

<https://www.ato.gov.au/Business/Reports-and-returns/In-detail/Examples-of-building-and-construction-services/>

PPSR | Australian Financial Security Authority

<https://www.ppsr.gov.au/>

Insolvency checklist

<https://rapseygriffiths.com.au/questionnaire/>

Corporate turnaround: What you need to know

<https://rapseygriffiths.com.au/corporate-insolvency/corporate-turnaround/>



NEED EXPERT ADVICE?

Contact us for a free, confidential
consultation today.

1300 727 739

rapseygriffiths.com.au

LOCATIONS

NEWCASTLE

Level 5,
55-57 Hunter St.
Newcastle NSW 2300
1300 727 739

CENTRAL COAST

Suite 320,
1 Bryant Drive
Tuggerah NSW 2259
1300 727 739

TAMWORTH

1st Floor,
12A Bourke St.
Tamworth NSW 2340
1300 727 739

SYDNEY

Level 17, The Ark,
Coca-Cola Place
40 Mount Street
North Sydney NSW 2060
1300 727 739

PERTH

Level 3,
267 Georges Terrace
Perth WA 6000
1300 727 739

BRISBANE

Level 10,
15 Green Square Close
Fortitude Valley QLD 4006
1300 727 739

MELBOURNE

The Lantern,
707 Collins St.
Docklands VIC 3008
1300 727 739

ADELAIDE

Level 5, City Central,
Tower 2
121 King Street
Adelaide SA 5000
1300 727 739



RAPSEY GRIFFITHS

TURNAROUND + INSOLVENCY

We are experienced and registered: As Registered Liquidators and Registered Trustees in Bankruptcy we have the expertise and authority to act.