Complete Experts Guide to Company Voluntary Arrangements

Written by Keith Steven

Welcome to Keith Steven's Expert Guide to The CVA Mechanism

KSA Group Ltd managing director Keith Steven has been turning companies around since 1994. He has been involved with thousands of companies and SME businesses in that time, most were facing insolvency, distress, closure and bad debts. Plus the people involved often faced terrible stress, the possible loss of homes and in some cases, risk to their marriages.

Many of these were helped by using the powerful Company Voluntary Arrangement (CVA) process with our practiced experts guiding them through the process. Most CVAs were accepted by creditors but a number were rejected (see REASONS WHY CVA's ARE REJECTED below) and many continue to trade successfully today.

It is true to say that many companies closed down or were liquidated, as it is obviously not possible to save every company facing loss of markets or customers, or changes in the economy as technology advances.

Having been involved in these cases there is not much that Keith doesn't know about the fantastically powerful CVA process. The real worry Keith has is that most distressed company directors still don't know what it is or understand just how it can be used to restructure and turnaround business.

So this CVA Guide is designed to SPREAD the CVA WORD!

We have set out this guide to be as user-friendly as possible, but please remember whenever you have questions you can email them to us for a quick answer. We will answer all questions during our office hours of 8.30 to 6pm, 5 days a week. This email support service is FREE.

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Introduction to the Guide

Are you a Worried Director?

Well, as we all know, there are any thousands of things that can go wrong in a business but always remember this. The business generates economic activity, employment and adds value to both the local and national economies.

If you started the business, or are one of the directors, you will know that it is a lonely profession, being an entrepreneur or a struggling MD!

If you are a director of a larger or more established concern, then you will know just how critical the business is to its employees, its suppliers, its customers and stakeholders.

Make sure you read this guide and www.companyrescue.co.uk BEFORE making any decisions on the options available. We always offer a free consultation, and this can help improve your knowledge of the options available. Challenge the perception that insolvency options like CVA are "not for my company". Think instead of how you might restructure the business given the power to do so.

Are You A Professional Advisor? Think of these Benefits.

If you are a professional advisor, why not read this guide and learn how to SAVE YOUR CLIENTS. What is the point in passing the client to other firms of insolvency practitioners that will simply bury it? This programme could lead to improved cashflow, new billable time and the retention of long standing clients.

KSA Group: Our Aim Is To Rescue Viable Businesses!

We help many thousands of people every year, they run different and diverse businesses. Most are fantastically hard working, many are innovative and creative, others are great with numbers or processes, and still more are great leaders. BUT all of the people we work with and help share ONE COMMON TRAIT: The emotional roller coaster of insolvency.

For small and medium companies it's been a tough period this last few years since the credit crunch and now with a global pandemic affecting EVERY company one way or another it is set to get tougher as we recover from the UK's worst ever recession.

So it makes a lot of sense to protect your hard work, your past investment of time and money and look to the future. Now it is all about survival, then turnaround, then recovery and hopefully you can still be able to grow longer term.

By starting with a fresh plan think how, by cutting costs, getting rid of surplus people and planning to be in business when the turnaround comes, we can help with that planning as turnaround experts.

So let's start with a well used turnaround phrase, "You are where you are". There is no time for blame or recrimination it's all about one thing now……….

FOCUS ON SAVING YOUR BUSINESS POST COVID-19

"Running a business that's approaching insolvency, or that's actually insolvent is an emotional roller coaster; there are good days and bad, great successes and depressing failures.

Remember, although you have fought many battles before on your own, now you have the UK's leading Company Rescue firm on your side and we know what you're going through"!

Keith Steven KSA Group November 2020

UK Definitions of Company Insolvency

You may think that having a cashflow problem is not the same thing as being insolvent, or the business is not at risk really of insolvency, so why do I need to focus on saving it?

UK insolvency law is built around the Insolvency Act 1986, the Enterprise Act 2002, the Company Directors Disqualification Act 1986, and now the Corporate Insolvency and Governance Act 2020. These statutes set out the law, but since they were enacted, many examples of case law and practical application by insolvency practitioners and the Courts have been enshrined in law too.

It is vitally important to understand that, if the business is insolvent, this results in a shift in the director's duty of care from acting in the best interests of the shareholders to ensuring the creditors' position is maximised.

If your company IS INSOLVENT whatever you do from now on you must act to maximise creditors' interests, that's the law. That usually does not mean stopping trading.

So although maximising creditors' interests is paramount, it can have the added benefit of rescuing the company too. Just to aid your understanding please now read the following definitions of insolvency:

There are three methods to determine insolvency:

1. **The Cashflow Test**
2. **The Balance Sheet Test**
3. **The Legal Action Test**

Insolvency Tests

The Cashflow Test
Simply put, can the company pay its debts as and when they fall due for payment?

For example if you are not paying the tax deductions from employees for PAYE and NIC across to HMRC each month on the 19th of the month following the month they were deducted, then the company could be insolvent.

If your trade creditors sell to you on say 30 days terms and you regularly pay on 60-120, then it can be argued that the company could be insolvent.

Should the company be insolvent the directors have a legal obligation to understand this issue. If he or she believes that the company has insufficient cash to pay its liabilities on time, then they should take advice and/or action.

The Balance Sheet Test
Simply – does your company owe more than it owns as a company? In accounting parlance are the company's assets exceeded by its liabilities? If yes, then the company could be insolvent.

It is important to point out that this test should include contingent or prospective liabilities. (If you need advice on these issues email us).

Many directors tell us that on a balance sheet test the company is not insolvent therefore they do not need to act.

However, under the cashflow test above the company may still be insolvent. So you must at the very least get advice if it is. We can advise confidentially and free of charge in the first instance and you can call 0800 9700539 to speak to an expert.

In our experience an apparently solvent balance sheet may include assets that are overstated, such as obsolete stock and work in progress, or debtors that are not really collectable. After deducting these items many balance sheets become insolvent. So be prudent - you are legally required to present accounts to show a true and fair picture of the business.

The Legal Action Test
If a creditor has obtained a County Court Judgment (CCJ), this may demonstrate the company's insolvency and the creditor may petition to wind up the company. (See compulsory liquidation). If a creditor has obtained a statutory demand for greater than £750 and it remains unpaid for more than 21 days, then the creditor may petition to wind up the company. (See compulsory liquidation).

If you believe that any of the above tests are positive for your business, it is vital that you and the board of directors take action to address the insolvent position. However, don't panic, look carefully at all pertinent issues and consider the rest of this guide and visit our website.

It's important to note that a company only has to fail <u>one</u> (or more) of these tests to be deemed as insolvent.

You MUST act to maximise creditors interests

Remember, if the company is now insolvent you must act to maximise creditors' interests, if **there is no reasonable prospect of the following options happening:**

- New or additional capital or finance being introduced to the business to return the balance sheet to a solvent position or to remove the cashflow pressures.
- A sale or acquisition of the company.
- A company voluntary arrangement or administration.

Then the directors may be accused of wrongful trading. If you are worried about this or your accountant has said that he/she is concerned, then look very carefully at directors disqualification.

Rule number one to remember now is: If the company is insolvent you must act to MAXIMISE CREDITORS INTERESTS. Failure to do so could lead to personal liability!

Every one of our new clients says:

“We wish we had met KSA sooner and acted quicker!”

So what is a Company Voluntary Arrangement?

This is the most popular question we get online or from callers to KSA.

A CVA is a deal between the company and its unsecured creditors, preferential creditors, trade and tax creditors, to repay them from future profits, or a deal may be written to sell assets and pay back creditors from the proceeds.

A CVA cannot include, or compromise the secured debt provided by banks or factoring companies.

The deal is based on preserving the company, rebuilding sales and profits and paying something back over a period of time to be agreed. Directors remain in control of the management of the business and the company's affairs; , personal guarantees don't get called in (usually) and it gives your business a fighting chance to survive.

Here at KSA Group, we start every CVA deal with a blank sheet of paper and a clear mind. Every case is different, we will ensure that the best possible CVA proposal is prepared for your company. There are some crucial points to consider before embarking down this path.

Based on our experience vital components of a successful CVA are;

- A viable business that can return to profitability. It will probably have traded and been profitable in the past. Start ups or non trading entities are not suitable for a CVA unless part of a group.
- A sensible commercially structured deal – PLEASE do not offer to repay too much too soon.
- The introduction of appropriate levels of working capital in addition to the restructuring of debt should be carefully considered as part of the future business plan.
- The management accepts that there has to be change in the management and company. What caused the problems (outwith the pandemic perhaps) and what will be done to ensure those issues do not reoccur.
- Directors and management need to be determined and hard work is essential, plus a bit of luck helps.
- Directors need to use expert CVA advisors to build the deal. Always ask advisors claiming to do turnarounds how many CVA's they've done!!

  Cautious forecasts - don't expect life in CVA to be easy!

So if your company can be viable in future but pressure is mounting this could be a powerful (but difficult) solution. Remember the directors should aim to maximise creditors' interests - by continuing to trade, you will do that in a CVA.

Business Viability?

After the directors have considered the long-term viability of the company it is essential to take appropriate advice from experienced turnaround advisors and insolvency practitioners like KSA Group. We believe that it is vital to have commercially pragmatic and creative specialists involved from as early a stage as possible.

If a company has a viable future, the directors and management accept the need for change, are prepared to fight for its survival and the appropriate funding (if necessary) can be found, then a CVA is a very powerful tool. BUT be prepared - it is a tough fight and it is harder than liquidating the company. By proposing a CVA you are demonstrating that you are trying to maximise creditors' interests so it can often be viewed positively.

If after that the CVA does work then the company will be profitable and valuable for the shareholders. If it is fails in its implementation the other solutions of administration and liquidation may need to be considered.

Who can propose a CVA?

A CVA may be proposed by the directors of the company. When the company is either in liquidation or administration, the liquidator or administrator can propose a CVA.

Yes the legislators way back in 1986 provided tools for liquidators and administrators to rescue a company through CVA.

A CVA can only be proposed if a company is insolvent or contingently insolvent.

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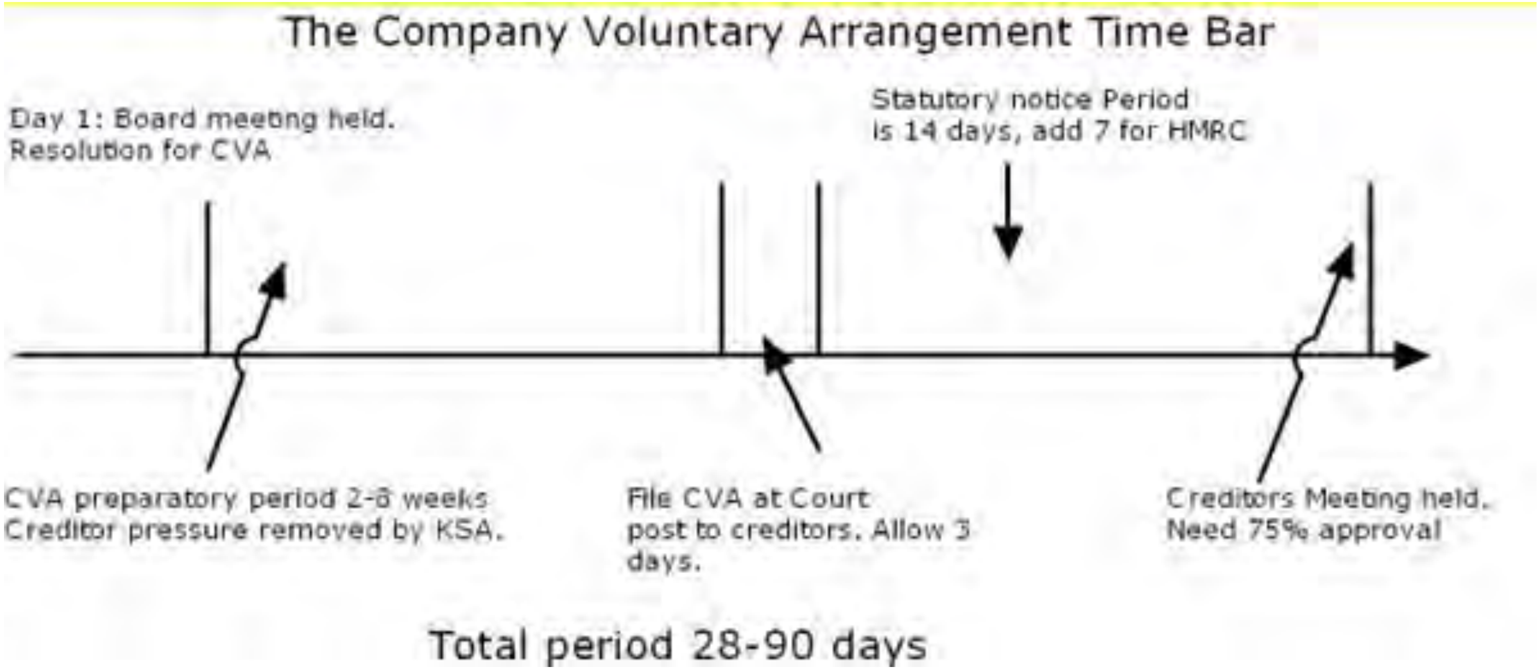
So how long does a CVA take?



How we handle CVA enquiries

When we receive an enquiry for a CVA we always act in the same measured and practiced way. Our trained advisors listen to the problems, ask educated questions, seek basic financial information from the caller and then consider any legal issues.

We normally have a chat through the issues facing people when they contact us electronically. That way we can quickly ask questions that can help us form a view.   If we feel we can help directly with a CVA or rescue approach, we often arrange a visit to have a face to face chat through the issues, followed by the issue of a detailed report. We do not charge for this process. Online video meetings are of course the 'norm' in 2020 but we will generally meet all of our CVA clients 'in the flesh' at some point during the process.

If we agree a way forward then fees would be discussed in advance of any work being undertaken. Generally our work is paid over a number of weeks from the savings we make in cashflow. Effectively, we get paid as we do the work. That's fair I'm sure you'll agree!

If we feel that the company needs to be closed or liquidated we will introduce you to one of our KSA licensed insolvency practitioners to consider a pre pack administration, a trading administration, voluntary liquidation or a sale of the assets.

But, if you believe the business is viable, we can help rescue and restructure the business with our in-house turnaround management experience and expertise.

We have to start somewhere so it helps us if you or your client can supply the following basic information to start the process.

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What Initial Information Do We Need?

1. Where is the business based?

2. What does it do and what is the turnover?

3. What legal status – limited company, LLP, partnership or sole trader?

4. Assets - approximate value:
   - 4.1. Plant and equipment, motors, fixtures and fittings etc.
   - 4.2. Stock and work in progress, debtors, cash.

5. Liabilities:

   5.1. Bank – overdrafts, loans and factoring or invoice discounting facilities.

   5.2. HMRC; PAYE, CIS, Corporation Tax or VAT Arrears and current liabilities.

   5.3. Trade creditor liabilities.

   5.4. Other information such as hire/lease purchase agreements, directors loans, and unsecured loans.

6. Viability:

   6.1. Marketplace - brief description

   6.2. Orders, enquiries and future prospects - a brief description will suffice.

7. Management:

   7.1. Type of management.

   7.2. Any gaps in the team?

So, In Summary

Please note we don't need lots and lots of paper or files to make a decision to help. Just provide the basic information above or as much as you can to start with! Detailed information will be required if you decide to appoint us.

We can provide free telephone, online chat, online video or email support even if only some of the above information is received. After receipt, if we believe that we can assist the company we will attend a meeting free to the client at a mutually convenient time and place (usually on online video at this time) or at their business address.

This meeting is generally followed up by a unique detailed 'Solutions Report' that guides the directors as to the rescue options, this is issued as a pdf.

CVA Process - A Detailed Guide

1. The directors appoint advisors, such as turnaround practitioners or insolvency practitioners (IPs) to assist in the construction of the proposal. (Warning: Ask the IP how many CVAs he/she has written and got approved! KSA has helped with hundreds of CVA proposals on behalf of our clients).

2. During this "hiatus" period the company should not materially increase or decrease debts to any creditor, suppliers should be paid for supplies made (pro forma is not always easy!) and activity of the company continues.

3 A review of the company, its people, markets and systems should be undertaken. This is an important part of the process. Typically the CVA will include detailed 2-5 year financial forecasts to assist the creditors to make their decision to support the deal or not.

3.1. We ensure that KSA's bespoke highly detailed specialist forecasting package is used. After our expert forecasters have produced this based upon the directors' guidance, the directors can then be shown various versions and "what if scenario planning" can be used to build differing business variables.

3.2. What if we cut costs? What if we closed that outlet or factory? What if we reduced people and overheads? These and other questions should ALWAYS be carefully considered as part of the CVA process.

4. It is vital to remember that the company has the opportunity to sharply reduce costs of employment and overheads that would not be available to it ordinarily. What would the ideal turnaround plan look like, then work to build this with KSA.

5. So, make sure that the lowest level of costs is targeted. Use the CVA to terminate employment contracts, exit rental obligations under leases of property and assets and any other onerous costs. If the company is struggling to drive sales up then try and "fit" the costs to lower levels of sales. Making sales in a recession or downturn phase is tough, so assume that in a CVA it will be even tougher!

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CVA Process - A Detailed Guide cont…..

- KSA has a team of financial forecasting experts across the country. Their role is to help the director/s build realistic and achievable forecasts by questioning all of the financial information being produced. This process is never easy as sales have to be estimated, but I would always advise people to aim much lower in their expectations! Being pessimist is actually being more realistic for the company's future CVA prospects.

- Once the draft proposal is ready the directors will typically review and refine it with the forecasting expert or accountant and agree that the proposal is appropriate, achievable and maximises creditors' interests. If the directors do not believe that it is sensibly structured, or that the process has highlighted weakness in the business then it may be advisable to close the business. For example see our guide to Creditors Voluntary Liquidation (CVL).

- Once the CVA forecasting has been drafted the directors should then discuss the position with the company's' secured creditors. Experience tells us that the ability to deliver a quality draft proposal to any secured creditors at this stage is preferable to verbal assurances that a CVA will be written and the bank told what the contents are when it's ready!

- We find that the senior lenders and factoring companies are very keen to get involved and assist where they see a viable company. Often they will want to see how the company will repay the bank's debts. This should be included in outline in the document - of course the bank may not agree with the suggested secured debt structure but will usually negotiate with the directors and their advisors.

- During the CVA production or hiatus period, current assets such as WIP and debtors are collected, turned into cash and liquidity should improve. This should be used to fund the difficult period between appointment of CVA advisors and filing the CVA proposal document at court.

- In addition the company normally does not need to pay PAYE, NIC or VAT in the hiatus period as HMRC generally proves the debt to the date of the creditors meeting (this is a complex legal area).

- The CVA proposal and the nominated supervisors' report is then filed at Court to ensure that the proposal is ratified and carries a legal "originating application" number. Then it is printed and the proposal is distributed to all creditors via a secure webpage. The court does not have an active part to play in this process but the CVA proposal, that is provided to creditors, must be a true signed copy of the exact document filed at court.

Provided the company conforms to its CVA commitments and makes its contributions, then the CVA continues for the agreed period. The supervisor is generally not involved in the business management at all.

THE DIRECTORS REMAIN IN CONTROL!

After the CVA Proposal is completed….

1. The proposal must then be sent to all creditors who then consider it for the minimum notice period as above before the decision making process can be held (creditors meeting). This is usually held online now by audio or video call. If sufficient creditors request it, then the meeting must be held in person.

2. We find that the HMRC team set up to consider all voluntary arrangements - called the Combined Voluntary Arrangement Service - prefers to have up to 3 weeks to consider these complex proposals so we always allow more than the statutory 14 day minimum period for consideration, before holding the meeting.

3. The meeting will be chaired by the nominated supervisor or nominee who is a licenced insolvency practitioner (IP). Creditors are often represented by technical professionals from other insolvency firms. The aim of the meeting is to allow the creditors to question the director's proposals; however it is not a place for settling disputes.

4. At the decision making meeting the creditors vote on the proposal and the proposal will be approved if a majority vote of 75% by value of the total value of creditors at the meeting (whether in person or by proxy) vote in favour. A second vote excluding connected creditors is taken and provided that not more than 50% of creditors vote against the proposal it is approved.

So remember it is not 75% of all creditors, it is 75% by value of those who actually cast a vote.

5. **In our experience the voting at meetings is an area that concerns many directors.** Well, provided the work has been done thoroughly before the CVA is filed at Court then the worry should be reduced. In our CVA's the Combined Voluntary Arrangement Service, (CVAS) which represents HM Revenue and Customs, will support viable proposals that are well built and show proper care and attention to detail.

6. Given that from 1st December 2020 HMRC became secondary preferential creditors we know that HMRC will generally always vote. Ensuring a positive vote requires much work, careful preparation and a viable CVA proposal.

7. Given that the CVAS often represents the largest votes, then we ensure that they are comfortable with the CVA process very early in the cycle of events.

8. Proper communication with creditors is a vital part of KSA's strategy for helping you build a CVA deal.

9. The Chairman controls the ability to vote and provided creditors have been asked to consider a sensibly structured deal, almost all proposals are accepted by creditors. Also the creditors may wish to "modify the proposal" - once again the modifications need to be approved by the majority votes above.

10. This modification process is usually led by HM Revenue and Customs to ensure future debts are paid on time and future filing of tax returns is done correctly and on time. Occasionally other creditors may ask for a modification to the proposal.

After the CVA Proposal is completed…. cont….

11. At the same time as the creditors meeting the members (shareholders) meeting is held. Members decide whether to accept the proposal as made or modified and a vote of 50% in favour is required.

12. If both meetings approve the proposal the meetings close. The chairman must then issue a chairman's report, within 4 days, to all creditors and the court, stating what happened, who voted and how they voted. He or she will also file a report at Companies House. This ensures that the decision is now in the public domain.

13. Once approved all notified and included creditors are legally bound for the debt "frozen" in the proposal. No further legal action (except by leave of Court) can be taken against the debtor company and the creditors will receive dividends from the supervisor as described in the proposal.

14. After the approval the company must make the agreed contributions to the trust account administered by the CVA supervisor. Failure to keep up with monthly contributions may be deemed a default and the company voluntary arrangement can be "aborted". This usually leads to liquidation or administration.

15. In our opinion the best way to avoid this is to structure the deal on the following basis. Prudent forecasts of directors should be further scaled back and modest forecast profits should be used as the basis for contributions BUT:

After the CVA Proposal is completed cont….

A. No more than 50% of profits after tax and debt repayments over the deal period should generally be contributed.
B. Contributions should be stepped to match profits achieved.
C. Any lump sum contributions during the period of the CVA should be avoided where possible unless assets are being disposed of as part of the CVA proposal.
D. The use of a profits ratchet allows higher repayments if modestly forecasts profits are exceeded. (This is a standard requirement of HMRC).

16. **Even if the approach outlined here leads to full repayment of HMRC as secondary preferential creditors and nil or very small repayment levels to unsecured creditors, the creditors usually prefer sensible CVA contributions to hopelessly optimistic forecasts.**

Provided the company conforms to the CVA proposal and makes its contributions, then the CVA continues for the agreed period. The supervisor is generally not involved in the business management at all. **THE DIRECTORS REMAIN IN CONTROL.**

What if things don't go well?

If the company is not performing well and yet it would still appear to be viable, then it is theoretically possible to reconvene the creditors meeting at any time during the CVA period to ask the creditors to consider directors' modifications (or amendments) to the original proposal, to the proposed payments into the scheme or the length of the scheme for example.

If the Supervisor has concerns, he/she (or they) can also ask the Court for directions. In most cases the directors should inform the supervisor if there are any material changes to the company or its business during the CVA period.

What happens at the end of the CVA period?

Once the agreed CVA period is completed and the supervisor has issued a completion certificate, then the company exits the CVA. Any remaining unsecured debts (where partial repayment was approved) are written off and the directors continue to run the business for the shareholders.

It is also worth pointing out that the CVA is not a panacea for your company; but it is a very powerful framework for change and protection of a distressed but viable company. In reality although difficult to propose and get approved, getting the CVA approved is the easiest part of a rescue/turnaround– making a turnaround work is much more difficult and often needs professional help.

Remember the CVA should aim to;

- Maximise creditors' interests.
- Preserve viable but distressed businesses.
- Preserve economic activity and save jobs.
- In time, return value to the creditors.
- Provide a real prospect of a return for shareholders longer term.

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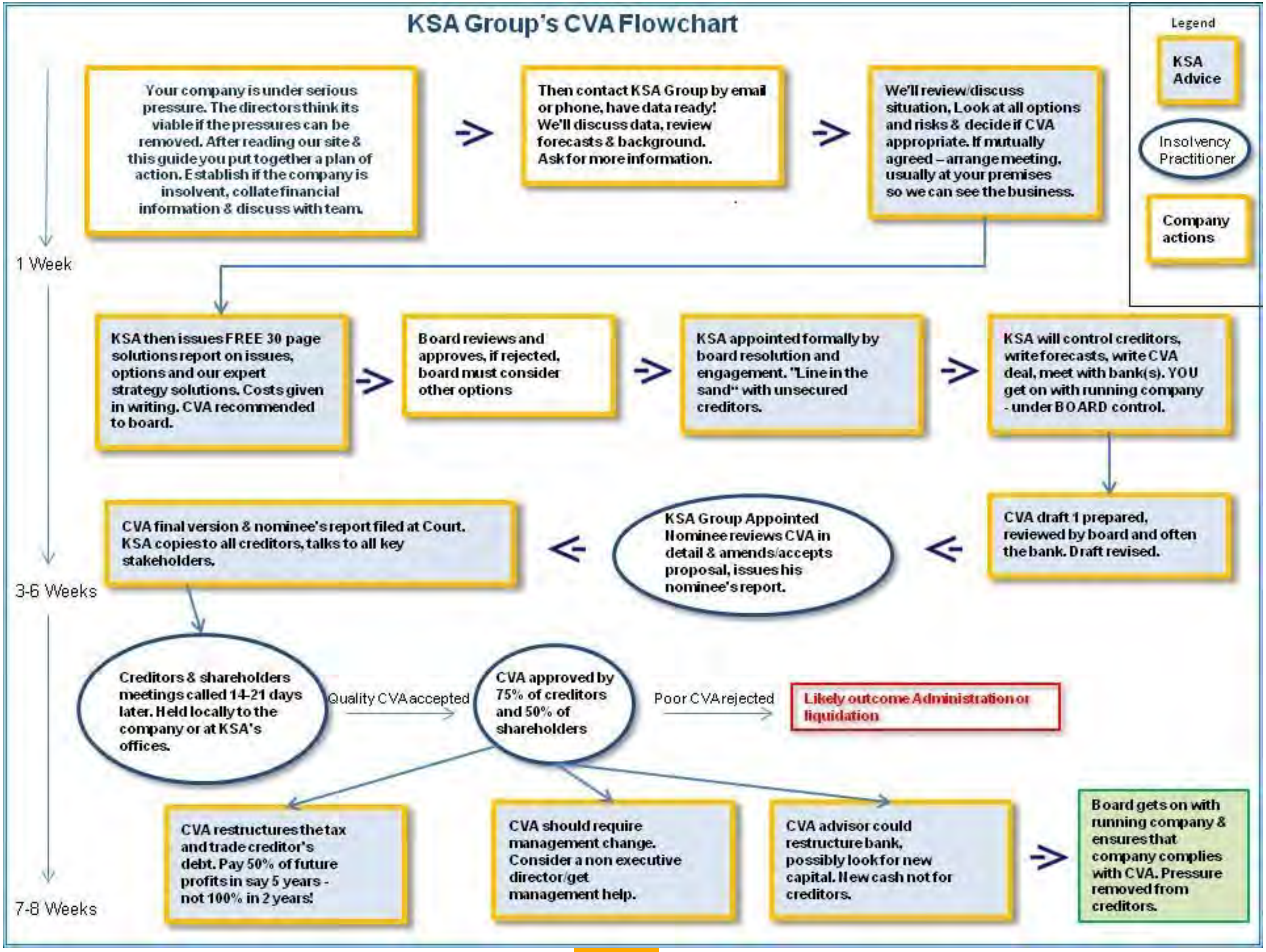
KSA Group's CVA Flowchart
Legend
KSA Advice
Insolvency Practitioner
Company actions
Your company is under serious pressure. The directors think its viable if the pressures can be removed. After reading our site & this guide you put together a plan of action. Establish if the company is insolvent, collate financial information & discuss with team.
Then contact KSA Group by email or phone, have data ready! We'll discuss data, review forecasts & background. Ask for more information.
We'll review/discuss situation, Look at all options and risks & decide if CVA appropriate. If mutually agreed – arrange meeting, usually at your premises so we can see the business.
1 Week
KSA then issues FREE 30 page solutions report on issues, options and our expert strategy solutions. Costs given in writing. CVA recommended to board.
Board reviews and approves, if rejected, board must consider other options
KSA appointed formally by board resolution and engagement. "Line in the sand" with unsecured creditors.
KSA will control creditors, write forecasts, write CVA deal, meet with bank(s). YOU get on with running company - under BOARD control.
CVA draft 1 prepared, reviewed by board and often the bank. Draft revised.
KSA Group Appointed Nominee reviews CVA in detail & amends/accepts proposal, issues his nominee's report.
CVA final version & nominee's report filed at Court. KSA copies to all creditors, talks to all key stakeholders.
3-6 Weeks
Creditors & shareholders meetings called 14-21 days later. Held locally to the company or at KSA's offices.
Quality CVA accepted
CVA approved by 75% of creditors and 50% of shareholders
Poor CVA rejected
Likely outcome Administration or liquidation
CVA restructures the tax and trade creditor's debt. Pay 50% of future profits in say 5 years - not 100% in 2 years!
CVA should require management change. Consider a non executive director/get management help.
CVA advisor could restructure bank, possibly look for new capital. New cash not for creditors.
Board gets on with running company & ensures that company complies with CVA. Pressure removed from creditors.
7-8 Weeks

Company Voluntary Arrangements - Worries and FAQs!

These are the classic worries we have heard for more than 25 years whilst assisting clients propose CVA's!

So, if you are considering a CVA, or your advisors have carefully recommended using the CVA process to rescue and restructure the company, you as directors, may well have a lot of fears and worries about taking this path.

Clearly this is a huge decision for the directors to make. Make it wisely by reading all of the relevant pages in this guide.

Q. Will we lose our customers?

A. No, generally you will not! In over 700 cases people have said this to us and we understand why. But, in practice, we have rarely seen a customer walk away from a business that is delivering its products and services, delivering well and on time. Shouldn't that be your focus?

Stop firefighting and get back to doing your main roles. Make sure you deliver what your customer purchased on price and on time. This way customers will normally stick with your company. But keep firefighting and sooner or later your performance will falter and their business may suffer. THEN you may lose them.

Q. Should we tell our customers?

A. My strong advice is YES. These are key stakeholders in your business but being blunt without them the CVA will probably fail before it gets under way.

Many people tell KSA "we cannot tell our customers that we are doing a CVA or they will walk away". That is your decision and one that should be based upon knowledge of the business relationship, their requirements and any contracts. Sometimes the best answer is to update them with professional CVA advisors in attendance. Often this is better than a competitor telling them that you have "gone bust"?

Think what you would feel if a major supplier did not tell you of their problems and their plans to deal with it, but instead they hear from a local rival that you have "gone into liquidation"?!

Q. Will our employees walk out!

A. No, in the current climate of rising unemployment generally they will stay. If they walk out they will lose any employment rights and will not receive any redundancy, lieu of notice payments from the company or DBEIS. Furthermore, they will not be eligible (generally) for unemployment/job seekers/ universal benefits.

So I recommend being open and honest and working out a plan for and with the employees. Proper communication is vital.

Some employees may lose their jobs as part of the restructure; this is painful and at times inevitable. We can work with you to achieve this.

More Worries and FAQs!

Q. Will our creditors stop supplying us!

A. No they won't! They need to maintain their sales to your company, as much they don't like losing the money owed. We spend a lot of time on "creditor liaison".

By carefully explaining to your creditors what the company is doing, how it will be in their best interests and asking them to work with the company and ourselves, we usually ensure that supplier creditors are kept informed and on side.

Don't expect any credit terms or any favours, but being honest and open with them pays dividends in the long run. After all, it would actually be simpler to simply liquidate and walk away wouldn't it?

You are trying to maximise creditors' interests by doing the CVA thus it's often in their interests to work with you and with the plan.

Q. If we propose a CVA what will the bank's reaction be?

A. In our experience if the bank, or factoring company is presented with a vague "we might do a CVA" approach they will often become very worried very quickly! As you will recall from above, preparing the CVA is the job of the directors and their advisors. Uncertainty and vagueness can lead to worried bank managers.

A properly structured and pragmatic deal that is based on reasonable assumptions will be much more acceptable to the bank or factoring company. In other words, prepare the draft CVA with your insolvency practitioner and build an outline for dealing with the secured creditors immediately.

Then approach the bank. The local branch manager must pass the proposal to the banks' debt recovery unit and cannot (usually) affect the outcome of the deal. If he/she understands the business well and is friendly they will probably support the deal if they can.

Remember the bank is (usually) secured, therefore the CVA cannot bind the bank in legally, but conversion of the overdraft into a longer term loan may give the bank more comfort that the company is keen to repay the debts. Talk to a turnaround practitioner used to dealing with banks.

Q. Will the bank/lender appoint a receiver/administrator!

A. Not usually - IF a cogently structured plan and a well, presented approach to the bank is used. In 25 years I have only see a bank do this on a small number of occasions and that was because they did not believe the directors were acting properly, based on a poor prior relationship.

Most banks and factoring companies are much more supportive now of "out of court" restructurings like CVA as it avoids the usual huge asset meltdown and costs of say trading or pre pack administration. Although the CVA cannot affect the rights of the bank or lender (if they are secured creditors), they are KEY stakeholders and should be closely involved in the CVA process.

THE FIRST QUESTION ON THIS PAGE IS ONE WE HEAR VIRTUALLY EVERY DAY AND IT IS A VERY FRUSTRATING ONE – SO PLEASE READ OUR GUIDE CAREFULLY AND THEN YOU DECIDE WHAT THE RIGHT APPROACH IS.

MANY CVA ADVISORS SIMPLY GIVE OUT WRONG INFORMATION ON THIS SUBJECT.

More Worries and FAQs!

Q: Someone told me that if we do a CVA the company has to pay back 100p in the £1 or the tax people will reject the proposal is that correct?

A: CATEGORICALLY **NO!** The amount the company pays back should always be based upon affordability not some arbitrary number divided by 36 monthly payments. We always work out a 2-5 year programme with supporting and highly detailed forecasts. Then the result is a better structured longer lasting CVA.

The Revenue and VAT people will be happier to support that plan than a half baked scheme that takes the total unsecured and tax debt and divides it by 24 months – to get a simple 100% repayment. This method is usually doomed to failure!

Under the law there is NO minimum payment or dividend as it is known, the law simply lays out a method for offering a deal to the company's creditors.

Q. Will HM Revenue & Customs support a CVA!

A. Yes, they will if it is a properly structured, well thought through plan and the company has been compliant with tax rules in the past.

The HMRC section that decides on these proposals is called the Combined Voluntary Arrangement Service (CVAS).

HMRC has a duty to consider the deal and the normal process is for the nominee (an insolvency practitioner) to contact HMRC and say a CVA is being prepared. The collector or debt recovery unit will then pass the file to the CVAS section in Cardiff.

Once received, the experts there will consider the nominee's repot and the CVA proposal document very carefully and then vote accordingly.

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More Worries and FAQs!

Q: We are about to sign a new contract with a very important customer - if we propose a CVA what should we do about them?

A: Often clients think that the new contract is dependent upon the quality of your product and or service, but the customer will be checking the company's ability to fund itself and to be in business some months or even years down the line. Again a concerted and controlled approach (typically led by the advisors) will often generate positive results. Talk to your advisors about this and decide on appropriate action.

Q: What will my creditors think?

A: Of course they will be disappointed - think what your reaction is when a customer fails, but with the correct approach they will understand. Perhaps they realise that you have been under pressure for a while and that by proposing a CVA you are trying very hard to protect the business. By proposing a CVA your company is demonstrating that you are trying to maximise creditors' interests so it can often be viewed positively.

Q: A Bailiff or Sheriff has walking possession; if we propose a CVA what should I do about that?

A: It is all about communication. We would advise talking to them when the time is right, gently pointing out that the assets actually are charged to the bank (or other secured creditor) and that the company is seeking to maximise all creditors' interests by proposing a CVA.

They will listen if talked to in a mature way. Payment of their outstanding costs can often remove the pressure whilst not actually paying the petitioning creditors debts.

In extreme cases the debt may have to be repaid. If the amount owed is too high then the company may have to enter administration to prevent the legal actions escalating. That's an expensive step so exhaust all other options first.

Q: The business is viable but why do a CVA - why not just 'dump it' and do a 'restart'?

A: If you are determined to liquidate and start again perhaps even the strong economic and business arguments against liquidation are not being understood. Remember the preservation of goodwill, preservation of tax losses; costs of liquidation, increase in creditor's claims and severe reduction in value of assets are powerful arguments to preserve a viable company. You also have a legal and moral responsibility to maximise your creditors' interests.

The risks of so called "dumping it" to avoid paying your creditors include: possible disqualification as a company director, being made personally liable under the Companies, Insolvency and Criminal Justice Acts, and being pursued for any misfeasance or wrongful trading. Of course the risks are small but you should carefully consider and weigh them up.

More Worries and FAQs!

Q: What happens to my Personal Guarantees (PG's) if we propose a CVA?

A: They are guarantees that cannot be removed unless and until the debt is paid off. The longer term repayment to secured creditors should be considered as part of the overall restructuring. Once the debt is cleared there is no reason why PG's cannot be removed.

A CVA will normally not lead to these being "called in" as long as a careful plan to deal with secured debt is set out to the lender. Again banks don't want to chase people for PG's, they want to lend to responsible and viable businesses.

Q: We have big tax losses - won't we lose them in a CVA?

A: No. they can be used in future providing they are recognised losses by HMRC.

Q: Can the company be protected from an aggressive creditor while we propose the CVA?

A: Yes there are two methods; one relies on case law and practice and the other is a formal moratorium. See guide to the formal moratorium below. For a full explanation of how the new Act's moratorium process works talk to an insolvency practitioner. This method is not popular because it places potentially huge and onerous risks on the nominee (IP).

Under case law, providing a creditor has less than 25% of the overall debts of the company then they can be required to consider the proposal even when a winding up petition is issued. (Dollar Land Feltham & Ors). A petition may be stayed and adjourned if a carefully structured plan is put together. If required a CVA can be rapidly prepared to show there is a "reasonable prospect" of the CVA being approved, then the Court will usually adjourn a hearing.

This is a complex issue beyond the scope of this guide, but feel free to email us if you have any questions.

Q: Can we continue to trade while we propose the CVA?

A: Provided it maximises creditors' interests it is essential to keep trading

Q: Is it expensive? How do we pay the cost of a CVA?

A: In comparison to other forms of insolvency, no it is not expensive. Individual circumstances determine the costs; but do speak to a turnaround practitioner or an insolvency practitioner about this area. Because payments to the Crown and other non essential creditors are suspended whilst putting the deal together, cashflow may improve allowing payment. However, many IP's and practitioners will consider spreading the cost of their work to match cashflow ability.

Dealing with Secured Lenders – Banks, Leases, Factoring and CID.

Many of our clients were initially worried that the secured lenders will not support the restructure of the company using a CVA.

All major clearing banks have a pretty healthy approach to restructure where the directors are acting responsibly and quickly. Banks fear control is taken away from directors by petitioning creditors like HMRC or suppliers.

So when a company is at risk (and generally the bank will know there are difficulties even if the board has kept quiet) the bank will monitor events, filing of management information, annual accounts, County Court Judgments and other legal actions.

In our view, it is always best to get the bank involved as soon as possible. Usually we advise clients to go to the bank with the solution generally mapped out. This may require a plan in writing or say a PowerPoint Presentation and at least a semblance of a CVA proposal with a statement of affairs even if the finished article is some way off.

In general terms the bank will often see the CVA as positive because it helps cashflow, reduces the risk of creditors' legal actions and it shows the board is acting professionally and properly in a timely fashion.

The bank manager or factoring manager will often pass the client to the bank's special risk teams for assessment and review.

Bank debentures and lending facility letters generally provide for the bank to appoint a receiver or administrator in the event of default. This is known as the bank's remedy. But this is very rare in a CVA scenario. The bank will prefer to keep its powder dry and keep their remedy in abeyance.

The bank will generally not want to appoint an administrator, because this could lead to a reduction in the value of assets and in the business itself. In some cases the bank would see a lower recovery from administration and therefore seek to rely upon your personal guarantees.

A CVA does not normally impact upon the banks security and may not crystallise losses, unless agreement is reached with the bank as part of the CVA scheme.

Dealing with Secured Lenders cont…….

A well structured CVA can greatly improve the bank's recovery, maintain its security and remedy and so the banks are, in our experience, very supportive of a well structured CVA recovery plan.

It is possible that a CVA alone cannot provide the working capital improvements needed. How do we assess this and find solutions?

Our very detailed financial forecasting (modeling) process will highlight cashflow issues early. Then it is a case of managing the costs and cash outflows to ensure survival during the CVA preparatory period and beyond.

For example KSA has frequently asked for capital payments holidays for lease and HP agreements and bank loans. If a good case is made using quality financial forecasts and cashflow projections then often, the secured lender(s) will agree to help the company through the difficult periods ahead.

I cannot stress enough that banks usually want to support their customers, they don't want to knock the business down and see a possible loss. Even with personal guarantees in place, they will seek to find solutions with the company's board.

HOWEVER, if you don't "act", don't provide the bank with information and don't seem to "get" how bad things are the bank can appoint investigating accountants or even worse administrators very rapidly.

What are investigating accountants (or reporting accountants)?

When a business has financial or operating difficulties it can often breach its borrowing facilities from the bank or from factoring companies. This can lead to bounced cheques, problems with the payments of direct debits, 'drawdown' difficulties, missed loan repayments and generally builds pressure on the cashflow.

Banks have quite sophisticated systems for monitoring this risk, but often they are "in the dark" with regard to the up to date financial performance of the company that owes it the money. One way of addressing this is to demand (as their borrowing conditions usually allow) detailed and up to date information from your company.

If such information is difficult or impossible to produce because of failings in the financial reporting systems within the business then they will worry that old and out of date information is being used to run the company and their lending could be at even more risk.

You may have noticed by now that bank's do not like risk! So the next remedy is to insist upon the introduction of investigating accountants. This will normally be paid for by the company, thus the act of appointing investigating accountants could lead to further breach of the facilities!

Investigating accountants (IA) usually have a brief to investigate the following:

- Cashflow, current daily and for say the next 12 months, month by month.
- The current profit and loss activity, previous results and forecasts for say the next 12 months, month by month.
- Performance against your past forecasts (in other words can your forecasting be relied upon).
- They will investigate the current creditors and forecast that for say the next 12 months, month by month. They will look for red letters from creditors leading to CCJ's Warrants, Statutory Demands and winding up threats.
- They will check to see if the company is up to date with the Crown creditors (PAYE and VAT) or if in arrears.
- They will check the quality of debtors and current assets like stock and WIP in the business.
- The strength of financial reporting will be assessed, as will the people involved.
- They will look at the business and marketing plans and check whether they are fit and feasible for the business.

Taking all of the above into consideration they will then write a report for the lender to state the options the lender should consider and what their recommendations are.

The options they can outline for the bank are not covered in this guide (see www.companyrescue.co.uk for more in-depth guides to administration, liquidation), advancing more money to help a short term requirement (yes that does happen!), withdrawing banking facilities, asking the shareholders to put more money in etc.

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More about investigating accountants……

What will this cost?

Well, the answer is how long will it take and who is doing it. Usually it is an insolvency practitioner and some of his/her managers/admin staff as a team.

I have seen IP's charge anything from £7,000 to £200,000 depending upon the complexities and size of the company or group. BUT the bank almost always insists that the company pays for this. Even if you refuse to pay and refuse to issue a payment, the bank has the ability to "dock" the money from the company's account!

But we cannot afford that?

Yes that's part of the problem. You can always refuse to pay and state that the board/finance managers will do much of the information provision, but generally there is a significant cost and it is seldom that the bank gets the work done for nothing or agrees to pay for it.

All the more reason to go to the bank and show your funder you are acting with a CVA and as a board, not sticking your heads in the sand.

Will we see the report?

Often not all of it no, however if you have a cooperative approach then the bank will share some or all of the report with you. Often the recommendation in the report remains confidential. So you may pay for it but you often cannot get access to it.

Will we have any input into the report?

It's much better to take part and put your views across forcibly with good information to back it up. So if you have not got that level of information (particularly as described above allied to information on orders, sales, enquiries, marketing, restructuring plans, downsizing and cost cutting) then you must get it in order to get your views across.

Who can we get to help?

You can often get assistance from your accountants/auditors. But if they're not up to speed with the problems then that can be counter-productive as they will generally look on negative information as a weakness that the bank may exploit.

We can help your business prepare restructuring plans; we have worked with dozens of companies and advised them how to plan their actions when the bank starts putting pressure on the facilities and asking for investigating accountants. Then we will normally help present those plans to the bank, this may avoid investigating accountants or indeed reduce their negative reports to the bank.

Our adage is "go to the bank with the solution not the problem"!

Landlords and CVAs

Most people, including many landlords, are completely unaware that a CVA (or any voluntary arrangement) can indeed terminate obligations to pay rent and service charges under a lease, it can terminate a contract or supply contract, employment contract and HP agreement.

We are often asked to cut these costs for our clients as a fundamental part of the CVA restructuring. So how does it work? Well this is a bit technical I am afraid but the CVA legislation was silent on many issues like contracts for CVA.

In the mid 90's some excellent case law was created that allows creative CVA practitioners to advise their clients on how to determine contracts.

The case law is in place to support well worded and structured CVA's setting out to terminate a lease. I very briefly summarise the case law for you below.

Re: Doorbar v Alltime Securities Ltd (1995) BCC 1149 stated that landlords can be bound by voluntary arrangements for future obligations under a lease. This is hugely powerful for the CVA (or IVA/PVA) process

Re: Cancol Ltd (1995) BCC 1133 Court decided that the word 'creditor' in r1.17(1) IR 86 was wide enough to include a landlord with a right to future rent – i.e. the ability to include future rent extends to CVAs as well as Individual Voluntary Arrangements.

Clearly, without writing a full book on case law this easy to read CVA guide cannot cover all of these cases in full detail; you will need to speak to insolvency lawyers, and insolvency practitioners for more details if you need them.

Furthermore, where the unliquidated or unascertained claim in a CVA involves future rents accruing to a landlord, the case of Re: Park Air Services [1996] BCC 556) gives the CVA meeting chairman some considerable guidance as to quantifying the claim at the meeting.

This approach appears to have been confirmed by Re: Sweatfield Ltd [1998] BPIR 276.

KSA has very extensive practical experience of advising our client on using CVA's to terminate lease obligations and in various matters surrounding the landlord and tenant issues that arise.

For example one of our clients won a Court of Appeal decision based upon appropriation of rent before and after the acceptance of a CVA after taking our advice - Re: Thomas v Ken Thomas Ltd (2006) B2/2006/0279.

This is a powerful affirmation of our advice we give to clients where there are rent arrears. Pay the ongoing rent and make sure we write to the landlord stating the arrears will be frozen in the CVA but ongoing rent will be paid. Then if the landlord does not appropriate the new payments against new rent demands he cannot claim the company is in breach for ongoing rent, in fact the landlord is in breach of the principle in Re: Thomas v Ken Thomas Ltd (2006) B2/2006/0279.

The CVA CAN compromise the arrears and it is a little known fact that a CVA can determine (terminate) a lease, it can control how new payments are appropriated, all very powerful tools to have at your disposal and illustrates why CVA's are deeply unpopular with landlords!

CVA Case Studies

See many more Case Studies online at www.companyrescue.co.uk

Digital Consultancy CVA

We were contacted by this London based digital branding consultancy in 2018. The company, which traded as an LLP (Limited Liability Partnership) had been trading successfully for seven years having seen a gap in the marketplace for online digital branding know-how. Having created a large membership of clients including many major high street and world renown brands it arranged digital marketing conferences and workgroups for members to share knowledge on digital marketing strategies.

The LLP suffered a severe downturn in business in the latter part of 2016 and all through 2017 for various reasons including reduction in client budgets, non-renewal of memberships and increased competition.

Cost savings were made, management overheads were reduced, and better contracts offered to lost clients at very competitive rates. However, despite the business addressing these issues a shortfall in cashflow remained. The business originally looked to bolster its cashflow problems by using borrowings and other financial arrangements, including term loans and an overdraft to finance itself.

It became apparent that the state of the cashflow was such, that significant restructuring of the business and its debts were required. The designated members of the LLP sought further advice regarding the LLP's options. After considering all options the decision was taken to propose a Company Voluntary Arrangement (CVA) to the company's creditors.

KSA worked closely with the designated members to structure a sensible deal that could be put to creditors in relation to their debts. During the 'exploratory' period we established that one of the designated members had provided personal guarantees to a number of unsecured lenders that had provided loans to the LLP. The individual did not have the means to repay any personal guarantee claims. KSA therefore structured an 'interlocking' (connected) IVA (Individual Voluntary Arrangement) for this designated member which would run alongside the CVA.

Unsecured creditor debts totalled c£254k and the LLP put forward a proposal to repay 43 pence in the £ to creditors over 5 years. Both the CVA and IVA were approved by creditors in April 2019.

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CVA Case Studies cont.....

Successful Exit from CVA Case Study

Written by Gary Weber National Turnaround Manager 6 January 2020

This West London based automotive parts supplier entered a Company Voluntary Arrangement (CVA) in October 2016. The company's creditors agreed a scheme for the company to repay them £418,000 over 5 years.

The company continued trading successfully initially, but faced additional external commercial pressures outside of its direct control. Currency exchange rate fluctuations meant it became more expensive to purchase supplies from outside the UK, some key suppliers had tightened credit terms and continued Brexit uncertainty meant that the board lacked confidence in the future of the company.

Having been in a CVA for 3 years and having repaid £265,000 to creditors over that period, the board decided that it needed to try and exit the CVA early to provide necessary confidence to the company's bankers, suppliers and customers. It proposed an early settlement to creditors by means of a full and final CVA dividend payment of £90,000. This meant that the company could exit the CVA and all the stakeholders could be confident that the company would have a bright future moving forward.

The CVA Supervisor put the early settlement proposal to creditors, who voted to accept the offer, as a full and final dividend payment and the company exited the CVA. The creditors received a total of £355,000 instead of the previously agreed £418,000 but it did mean they got paid two years earlier than they were expecting. They obviously preferred to accept a 15% 'discount' for an early settlement.

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DO YOU THINK THIS INNOVATIVE TURNAROUND APPROACH COULD BE A USEFUL TOOL TO HELP SAVE YOUR BUSINESS?

THEN YOU NEED TO TALK TO US NOW.

CVA Case Studies cont…..

Marine Hydraulics sector

This company specialised in marine hydraulics and started having cashflow problems in late 2013. After the purchase of two smaller companies in 2013, it had been hoped that this would be the end of their cashflow problems. However, together with this purchase, an unsuccessful product launch and bad debts, the situation worsened.

HMRC issued a winding-up petition in July 2015 which was paid by associated and connected creditor funds. Staff and costs were cut to try and deal with the cashflow pressures, but substantial restructuring was required.

The company, who has several customers who are in the top 100 companies and are spread throughout the world, approached KSA for assistance. We recommended that they propose a CVA to the creditors.

With the help of the CVA, the company reduced staff numbers and exited premises that were too expensive and no longer required. Creditor pressure was taken from the company as KSA dealt with calls from creditors chasing debt. An associated creditor agreed to convert their liability into preference shares and the CVA dealt with more than 100 creditors. The CVA offered 35p in £1 and was accepted by the creditors, HMRC included.

The directors are confident that they can work through the pandemic and complete the CVA as the company once again becomes profitable.

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CVA Case Studies cont……

Essex Company - Trading Out Deal followed by CVA

Based near Basildon this was a subsidiary of a German company. The MD saw huge problems ahead and despite being a Sunderland fan we spoke to him!

The company had been reliant upon Ford as its major customer and then expanded very rapidly with state of the art engineering/design facilities. They employed 120 engineers and then invested further in software. Ford then had a global cost cutting exercise and sales fell from £7.8m to £3m!

The German parent was keen to restructure it without a formal insolvency like administration but was also aware that it could not provide any more financial support (it had loaned c£3m already).

Initially we did recommend the CVA as the control technique to lead the restructure, but the board insisted on an informal time to pay deal with the PAYE/VAT and rates authority. We did this and got approval to pay the tax debts over 12 months.

Then sales fell again. We then insisted that the CVA was the correct control tool. But the building was like the Marie Celeste and they needed to sub let 20,000 sq ft to exit the property. This was achieved with our guidance and the power of the CVA which was approved by creditors. Our colleagues in our Stansted office have been providing hands on management accounting and outsourced quasi finance director roles.

Eventually the German owners wanted to exit the CVA and a deal was proposed to pay 30p in £1 immediately to exit - the original deal was 34p in £1. The creditors agreed to end the CVA and the company had therefore satisfied the CVA and is very profitable. It is now significantly larger business with subsidiaries across the world.

So another great job by KSA Group!

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CVA Case Studies cont......

IT Services company in Surrey

Our client was a growing ITC consultancy, it provided solutions, software, service and support. Growth was too fast for the working capital available and whilst it was profitable, cashflow was always a problem. Then sales slowed and the debt wave coming along behind them, threatened to wash over the business. The company was encountering further financial difficulties because of lower than forecast sales, high overheads, a substantial investment in a new CRM programme that was not quite market ready, a small number of bad debts from insolvent clients and incomplete projects.

A classic story of being undercapitalised, profitable but brought down when HMRC stepped in. Having had several time to pay deals over 2 years, the non payment of a large VAT bill brought the HMRC Debt Management Unit into play. No further TTPs would be agreed, the company needed to refinance and an EFG (Enterprise Finance Guarantee Scheme) loan was raised to pay off taxes and creditors.

What next? The new software took still longer and then the MDs father provided funding to tide the situation over, until next time.

What was the KSA rescue strategy? - **A Company Voluntary Arrangement**

We addressed this by setting out a strategy that would restructure the taxes, the trade and landlord debts. We assisted the board look at structural issues too we suggested that the company:

- Propose a CVA to reduce the burden of debts
- Make sure any payments were affordable
- Determine surplus employee contracts with CVA
- Dispose of excess and ineffective employees
- Nil cash cost to the company as the Redundancy Payments Office (part of DBEIS) met redundancy and lieu of notice claims.
- Determined expensive premises lease
- The current premises lease can be determined as part of the CVA and a new less expensive, more compact premises can be sought if required

DO YOU THINK THIS INNOVATIVE TURNAROUND APPROACH COULD BE A USEFUL TOOL TO HELP SAVE YOUR BUSINESS?

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CVA Case Study for IT services company cont....

The CVA Deal Was As Follows:

1. The company proposed to pay creditors £168,600 over 5 years.
2. Sales forecast to be £1,138,200 in the hived down to company in the first 12 months of the CVA period
3. Number of employees jobs saved was 16.
4. Discussions were held with the company's secured creditor, Clydesdale Bank plc. The company will continue to repay the EFG loan as per the terms and conditions of the loan.
5. The company is still in discussions with the bank with respect to the level of overdraft facility which it requires and the bank is prepared to provide. The directors hope to be in the position to update the creditors at the creditors meeting regarding any conclusion of discussions with the bank regarding the overdraft facility.
6. Unsecured creditors would receive: 40p in £1
7. Connected (associated) creditors will receive nil (directors dad). The connected (associated) creditors agreed to waive their claims and that their debt would not survive the CVA.
8. The CVA was approved, in January 2016, but even with the CVA removing debts, tendering for new work led to problems. This is because there is no credit rating awarded to companies in CVA. So after 10 months the directors managed to raise private investment and the CVA creditors agreed to a one off payment of £100,000 to close the CVA early.

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CVA Case Studies cont……

Sussex based UK building contractor

The director of a construction company contacted Sarah Massey of KSA to discuss the company's present financial situation. Then, after a subsequent telephone conversation with KSA regional manager, Gary Weber, a meeting was requested and held at the director's home.

KSA was appointed to assist the company with a Company Voluntary Arrangement (CVA) in August 2017. Turnover for the 2017 trading year, was c£215K. The company was encountering financial difficulties due to historic HMRC debt

Employees:

- The company employs 2 staff including the director It was not necessary to utilise the CVA to reduce costs via redundancies.

Bank & Financial facilities

- The bank was unsecured and provided no facilities other than a current account
- The company only had one finance agreement.

Director

- The director had provided no personal guarantees (P.G.'s) to any creditor.
- There was a small overdrawn director's loan account which was to be paid back to the company over the first 12 months of the CVA and will be made available to the supervisor of the CVA as additional contributions.

Unsecured Creditor debt:

- £30K of which HMRC was 92%

The nominee's review was held and the CVA and nominee's report were subsequently lodged at court. The CVA proposed 58p in £1 repayment to unsecured creditors over five years. HMRC provided their response accepting the CVA with modifications (conditions of acceptance). The CVA was accepted by the body of creditors at the creditors meeting and the company is now in CVA.

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Trade Creditors, Landlords and HMRC - why they WILL SUPPORT A GOOD CVA

We frequently hear the statement – ***"If we do a CVA our suppliers will not supply us so we need to pay them"!***

Our response is we will quickly deal with all creditor issues allowing the management to focus on the business, not firefighting. Often people tell us that this is the most immediate evidence that the corner has been turned and progress is being made.

Since KSA deals with the creditors calmly, professionally, dispassionately, and fairly, the creditors will continue to supply our clients (on proforma usually). There are no guarantees that a supplier will supply, post our involvement, but we can honestly say that we very rarely have any difficulties with continuity of business.

"Why will a creditor supply when they have lost money"? This is a favourite question from our clients.

The practical answer is most creditors want to see the continuation of steady business; obviously bad debts are not good news. It is worse still to lose a good customer as well!

In the current climate losing both would be a huge blow to your suppliers.

How expensive would it be for your creditors to find another customer to replace your business? What would you rather have, ongoing sales every week or a failed and liquidated customer?

The same can be said of landlords. A premises landlord will think very carefully before repossessing his/her property and forfeiting the lease.

Think about it, he/she would then have to find a suitable replacement tenant, maybe at a reduced rent and if the premises are empty for long enough, will be liable to pay business rates. The landlord would also possibly have to look at 'writing' off any rent arrears if the company entered liquidation. We will liaise and communicate with the landlord wherever necessary.

We also, immediately, contact the Crown (PAYE and VAT) and inform them of our involvement. This ensures that they are aware, cease action and they normally then wait for our proposals to restructure the company.

Often, informal deals can be reached (this means without using formal insolvency procedures) that allow a breathing space for the company whilst other restructuring is undertaken.

Our team of experienced advisors take the issues of cashflow and creditor pressure away smoothly and allows the management to get back to their proper roles.

Then after a few weeks of trading the CVA proposal arrives on their desk. It's a formalisation of the process, they know they have had good trade with you and they generally do not want to let that stop. So they will usually vote in favour whilst not attending the meeting.

DO YOU THINK THIS INNOVATIVE TURNAROUND APPROACH COULD BE A USEFUL TOOL TO HELP SAVE YOUR BUSINESS?

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CVA Moratorium

At the time of writing (late 2020) this section of the statute we believe, may or may not be withdrawn. As this is NOT a technical legal guide, we have decided to summarise our views of the formal moratorium process versus an informal approach.

As CVA experts we are often asked questions like these.... Do we need to apply for a CVA moratorium? How do we protect the company while the CVA is being prepared? Why don't insolvency practitioners use the CVA moratorium? Can the company be wound up by creditors before the CVA is approved?

KSA specialises in building successful CVA proposals, we know a “fair bit” about them having been responsible for hundreds of deals over 25 years. We have never used the formal CVA moratorium because in practice it’s too cumbersome for the company and much too risky for the nominee. We understand that very few moratoria have been applied for in the past version under Schedule A1 Insolvency Act 1986 introduced by the Insolvency Act 2000 or under the Corporate Insolvency and Governance Act of 2020.

- A statement that the company is eligible for a moratorium

Critically **a statement from the nominee is required when applying for a moratorium under CIGA that, in his opinion**

> "**The proposed voluntary arrangement has a reasonable prospect of being approved and implemented, and the company is likely to have sufficient funds available to it during the proposed moratorium period to enable it to carry on its business".**

This nominee's statement is the big issue here. After a few days of talking to a possible candidate for a CVA and preparing the CVA proposal, will the nominee know enough information about the company and its prospects to actually make that statement (that the company is likely to have sufficient funds available to it during the proposed moratorium period to enable it to carry on its business)? Who will vouch for that cashflow, would it be the IP’s staff on site each day, for example? How can the company afford that cost PRE CVA?

We believe that most IPs or nominees are unlikely to want to take that risk of stating categorically that the company will be have sufficient cash available in the moratorium period. Without knowing accurately the statement of affairs, financial forecasts, debtors, stock, work in progress, balance sheet, orders and so forth they will be worried about putting themselves at risk.

This we believe is the reason why tiny numbers of moratoria have been applied for.

The De Facto Informal CVA Moratorium

KSA specialises in working with debtor companies and their creditors to organise a "de facto moratorium". We are appointed by the client to act as advisors and then nominated supervisors. We talk to every unsecured creditor telling them of the CVA plan. This buys time so that we can put together the proposals in fine detail.

Creditors are told that historic liabilities WILL NOT generally be paid for as the company has a serious cashflow problem. In the meantime the company is continuing to trade and wants to buy products or services.

Common Sense?

Once appointed to assist the company KSA follows a well worn and successful path. During the CVA production period we help the client buy goods and services by negotiating pro forma terms. Over a period of weeks the creditors supply on nil risk terms (cash upfront) and this allows them to keep cashflow going and also demonstrates that the company is viable if the CVA was approved.

This pre-CVA trust building is often very important and shows that the directors are seriously trying to maximise creditors' interests, which is a legal requirement.

After a few weeks the CVA is filed at court and the trade creditors generally support because they want to recover debts and also keep the customer trading with them on nil risk terms.

What if a creditor starts legal actions?

In 1995 case law was reported that provides a very powerful argument. Re: Dollar Land (Feltham) & Ors [1995] BCC 740 reported that the court decided that a winding-up order should be rescinded if there was a real prospect that CVA proposals would be approved by the company's creditors. In other words let the CVA majority decide.

We use this argument to STOP petitions being issued in the first place, saving the creditor money for costs and fees and also removing the risk of the petition against the client.

If a petition is already issued before we're appointed to assist, and a hearing date is due before we can file the CVA meeting notice, we talk to the plaintiff to get them to stop their actions as above, or to prevent the advertisement of the petition. Usually the petitioner is the Crown (HMRC).

Most HMRC petitions are stopped or adjourned in this way so we can get on with the CVA production. This is a powerful approach that is built on common sense and a case that said "look is it equitable for one creditor to knock a company down when all the other creditors may agree a CVA"? Obviously not and we've defeated petitions in courts across the UK this way.

The De Facto Informal CVA Moratorium cont…

Aggressive Petitioners?

If the petitioner will not withdraw or threatens to advertise the petition, the company could use an application to Court to request a hearing adjournment and seek a Validation Order from the Court saying that the hearing is adjourned and the company can progress the CVA proposal to filing and creditors meeting.

The bank account is always frozen by the bank if the petition is advertised, so by obtaining the Validation Order the bank can then reopen the bank facilities.

So, we believe that by careful discussions and complete honesty with creditors, using powerful case law and common sense we can effect a de facto moratorium that works in virtually every case.

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Advantages and disadvantages of CVA and CVL for “ABC Ltd”

CVA Approach.	**Creditors Voluntary Liquidation (and restart)**
Control – directors remain in control.	The liquidator is in control. He decides if company assets are sold, its wound up or put into CVA
Breathing Space. Allow detailed analysis of the business requirements, production of marketing and business plan.	A phoenix is possible but the buyer of the assets needs cash and working capital to start again.
Defer VAT. Then available for CVA costs and working capital, not for creditors.	Fees could be £5-10,000, may be much higher
Time defined process – fixed date of creditors meeting means crystallising of position.	Trade stops for a period – often longer than 2-3 weeks, this damages customer relationship
May cause disruption to supplies while proforma is used. But trade credit will often be granted in 6-12 months. More accounting/admin. Work	Where will the business trade from? – a new lease will be required. Can terminate onerous contracts. New company must register for VAT and tax ASAP. Needs new bank account.
Personal guarantees generally not called in	PG’s crystallised, for directors

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Advantages and disadvantages of CVA and CVL continued

CVA Approach.	**Creditors Voluntary Liquidation (and restart)**
Flexible plan under the CVA, we would forecast minimal monthly contributions to the CVA as profits will be low in year 1. Profit related ratchet kicks in if the business exceeds profit forecast.	Writes off trade and tax debt. Clean balance sheet. Lose tax losses
No directors conduct investigation	Directors' conduct must be investigated.
Utilise current WIP/stock to turn into cash. Collect out the company's debtors	Debtors will be tough to collect, WIP/stock sold for nil value. Hence liquidation realisation for creditors often nil
No new capital needed to restart, simply use existing assets.	Will the new business have adequate working capital to survive a restart process?

Therefore, our strongly held view is IF THE BUSINESS IS VIABLE that the flexible CVA model is the most effective route forward. The bullet points opposite of the suggested CVA strategy are:

- **Propose CVA in 2-8 weeks, use period to build outline plan, work out requirements**
- **Buy breathing space, remove freneticism, allows controlled restructure. Get you focused on your jobs.**

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CVA versus Administration Comparison table for "ABC Ltd"

CVA Approach.	**Administration Approach: (plus or minus "pre-pack").**
Control – directors remain in control. They are helped by KSA. Obviously some directors do not want such close involvement.	The Administrator is in control. He/she decides if company is sold, liquidated or put into CVA. Directors have no control or input.
Breathing Space. Time to deal with the potential loss of confidence of any suppliers. Allow detailed analysis of the business requirements, production of marketing and business plan.	Breathing space to allow restructure, sale or closure. Company can propose a CVA if management and finance available.
Creditors receive dividends over time, they will be happy to receive that and KEEP a customer.	In pre-pack creditors receive nil/tiny dividend but may keep customer if they supply newco. If Admin followed by CVA they receive dividend.
The fees are not insubstantial for a CVA. They have to be paid out of cashflow. However, see below, cashflow is much improved by the CVA process.	Administration fees would be 5-10 times higher than CVA. Administrator controls the cash and takes his fees as he needs them (subject to later ratification from creditors). Administrator MUST pay tax and VAT during Admin period. If pre-pack used then the "Newco" must also pay tax and VAT from the outset. NO tax leverage.
Overdrawn directors loan accounts will need to be repaid to the company.	If not cleared before any Administration directors are required to **personally repay the loan**.

CVA versus Administration Comparison table for "ABC Ltd"

CVA Approach.	Administration and/or Prepack Approach
Time defined process – fixed date of creditors meeting means crystallising of position. KSA talks to creditors, removes pressure from directors	Equity value of the business written off. (Unless CVA proposed after Administration). Loans written off. You would have to "buy back" the business if pre- pack. Or third party can acquire it.
Flexible plan under the CVA, we would forecast minimal monthly contributions to the CVA as profits will be low in year 1. Profit related ratchet kicks in if the business exceeds profit forecast.	All invoices, purchase orders, faxes, emails and letters will have to state the company is in Administration. This would severely damage marketing and sales.
Protects the company from aggressive action by creditors. Exclude critical creditors but likely that company will have to pay upfront (pro- forma) for new services/ supplies.	Does not apply in pre-pack.
The company can utilise current work in progress to turn into cash. Collect out WIP & debtors. Both over time and with no reduction in asset value.	If not a pre-pack the business will be advertised for sale as a matter of course under SIP 13. Could be several interested parties who will need to be shown around and sales memorandum prepared. Debtors harder to collect.
Recommend a NED or "quasi" finance director involved going forward to help structure the financial reporting of the business, attract investment, adherence to CVA plan and building the final business plan.	If a trading Administration, the directors can be instantly removed without recompense under s13 Insolvency Act 1986. Administrator can appoint directors or managers.
No investigation into directors' conduct.	Investigation into the conduct of the officers in the 3 years up to the terminal insolvency of the company.

"You can still sell the business in CVA under the board's control. But the CVA Supervisor must be involved."

Summary

Considering the advantages and disadvantages of the two options, our strongly held view is that the CVA model is often the most effective route forward. The bullet points of the suggested CVA strategy would be:

- **Propose CVA in 4-8 weeks, use period to build outline plan, work out requirements.**
- **Buy breathing space, remove freneticism, allows controlled restructure. Get directors focused on your jobs not firefighting and fighting the Tax man.**
- **Recover control and refocus directors on the company.**
- **Get CVA approved help restructuring and attract new profitable business.**
- **Save a viable business and jobs.**
- **Drive the necessary turnaround process with much lower creditor pressure**
- **Avoid the possibly huge meltdown of Administration followed by pre-pack/liquidation will lead to.**
- **You can sell the business in CVA under board's control.**

CVA Preparation. So, Is My Company Viable for A CVA?

1. **Work out cashflow**

1.1. If you want a daily cashflow model to help you work out your business email us or visit www.companyrescue.co.uk

1.2. This will help you lay out the next 90 days of cashflow and see what the real cash position is. We use this for all of our clients. You should use it too!

1.3. Using a spreadsheet like the free model available from www.companyrescue.co.uk plus VAT; enter all known receipts from your factor and all know payments out.

1.4. Put them in where you think they will be received (cleared funds!!!) and when payments need to be paid.

1.5. Enter bank position (balance).

1.6. Work out the cashflow for the next 90 days.

1.7. So what does this say? Your company will run out of cash? Or can you live within the facilities if payments are pushed out a week or two? What if you move the PAYE and VAT out by a few months paying say a 6th each month? Can that work?

1.8. **Does the cashflow say it just cannot work?**

1.8.1. Don't panic! Now you have established cashflow that's a good start to working out the solutions.

1.8.2. You can stretch out the cashflow to 6 months if that would be useful to you.

1.8.3. Move onto the next step.

2. **Work out your Sales**

2.1. Now let's look at sales, are they falling, rising or flat?

2.2. If they're falling we know we need to work out if the company's costs are falling too. If not rising costs and falling sales are a real problem. See our guide to cost cutting.

2.3. If sales are falling is this a marketing problem? See marketing guides below.

2.4. Can you increase sales, if so how. Is there a new product or service that you can sell? How long will it take to get it selling. Do you need to spend money to get it to market? How much? Put that in the cashflow.

2.5. What about salespeople, are they performing? Do you have a web presence? If so is it working for you?

2.6. Work out the best sales you can expect for each month for 6 months, and then work out the lowest. This is called sensitivity analysis.

CVA Preparation. So; Is My Company Viable for A CVA?

3. **Look at your margins:**

3.1. Work them out carefully. Remember this is the difference between sales price and purchase cost. If you have no purchase cost (like software) then your margin is nominally 100%. If you buy something for 50p and sell it for 100p plus VAT then the gross margin is 50%. Remember if you buy for 50p and sell for 100p including VAT then the gross margin is NOT 50% it is 41%.

3.2. Can you put prices up and improve margins. Can you buy better and get cheaper supplies?

3.3. If you cut the margin would you sell more? Remember 10% cut in the sales price equals a much bigger cut in gross profit margins!

4. **What are the fixed costs of the business?**

4.1. These include rent, rates, utility bills, insurances and so forth. Add them up and see how much you spend on each and all fixed costs.

4.2. You need to have a enough gross margin each month to cover those costs.

4.3. Can you cut fixed costs like rents?

4.3.1. If not is the property too big and would the business do better in smaller premises.

4.3.2. Think about using a CVA to exit the property and terminate the lease.

4.3.3. If you cannot cut fixed costs then you may be able to save money on variable costs or overheads.

5. **What are your overheads (or variable costs)?**

5.1. These include people, travel, accounting, cars, electricity, consumables, stationery etc.

5.2. Are these too high? Save a pound or two on all of these and you could make a huge difference to the business' net margins.

6. People – good, bad, remove or recruit?

7. Customers, have you got enough are they satisfied with your service/product?

8. Marketing: have you got a plan, how do you get to market, what about the brand/product and market?

9. Business Plan – have you got one?

10. Emotion, pride and all that.

11. Decide to ACT!

11.1. I have a viable business???

11.2. I have an unviable business???

11.3. I have a viable business but it needs to be restructured???

Cost Cutting Guide

Cost Cutting Guide

Our TOP 20 Cost Saving Rules and Cashflow Tips for SME's

1. You should set up a daily cashflow to control all cash in and out. This may protect you from wrongful trading, as it helps manage cash and stops bounced cheques. If you don't have a daily cashflow forecast go here https://www.companyrescue.co.uk/guides-knowledge/news/free-tools-to-help-your-business-1648/

2. All purchases are approved by you as MD/FD/operations director/or owner. You should sign off on all payments or approve all online payments in writing.

3. No purchases are approved unless signed by you, which will make your team produce a purchase order. Then you can check if they are doing their job, is the price fair, are they and your supplier ripping you off, or are they just lazy and not achieving best business value?

4. No petty cash is drawn from the bank unless you personally go and get it… makes you question what every pound is spent on when people ask for cash won't it? By the way you get out of the grind and time to think.

   4.1. If not possible because your business is too big, why not make a trusted person do it. NOT a big issue if cash is king?

5. Review all expenses claims from staff; reject all that are not really necessary. If you get complaints or murmurings (they may be too scared to act professionally and debate with you), then meet with them and explain the position. BLUNTLY, tell them survival is now the main aim.

6. Remember survival is KEY, if you lose people or profits that's' not vital, CASH IS KING for now. Profits will soon flow from very tight cashflow management. If people sue for unfair dismissal, call us we can help, we may be able to kill off their claims with straight talking. Or perhaps a CVA can kill these claims too.

7. Ask every supplier for a review of their prices, can they cut you a better deal? Ask them to for a few extra weeks payment grace. They may object but they will welcome smart business people staying in business. That's better from a creditor's point of view than people putting heads in the sand!

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Cost Cutting Guide

Cost Cutting Guide cont…….

8. Ask the landlord for a breather on rent. Can you please pay monthly not quarterly for a while? This helps cashflow. It actually puts you in arrears but that's maybe ok at this stage. AGAIN they want a paying tenant not an ostrich who won't talk!

9. Ask your accountants to accept monthly payments. If your accountancy fee is £10,000pa then ask to pay over say 10 months that's £1,000 per month. The same applies for anyone else that issues a big annual fee note.

10. **MANAGE cash £VERY DAY! Did you do that yet!**

11. Get someone else's view; do you have a trusted friend? If so talk to them about your business, actions and get them to sanity check you. They may suggest cost savings, test your closeted views and make you think.

12. Do you need that company car; can you use your own and give it back?

13. Can you sell any assets, will it raise cash? Make sure they're not owned by a leasing company first.

14. Ask your factors to cut their costs, only drawdown weekly. Using your daily cashflow model will of course help in this. This can save hundreds of pounds a week.

15. Cut ALL overtime to the bone, why do you need it? Is your production planning so poor or weak? If you need more people hire them, at lower rates.

16. If you need to make redundancies and the company's cashflow cannot afford them, use the DBEIS Hardship Schemes.

17. KEEP MINUTES or notes OF ALL DECISIONS. If you're a partnership or sole trader KEEP NOTES. This will help protect YOU.

18. Be aware that people will be less organised than you, for goodness sake, if a customer is not paying find out why?

19. Manage cashflow every day, it is your main role first thing every day.

20. Get expert help on cashflow from your accountants, specialist cashflow advisors or KSA.

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CVA Forecasting

This could possibly be a long book in its own right! However, we use the following processes when producing CVA forecasts.

Separate forecaster to the CVA advisor: This ensure that a salesman cannot influence the views of the directors. Instead we provide a seasoned chartered accountant or certified accountant who will produce the forecasts with the directors.

“What if” scenarios, discussing cost cutting, reviewing sales and marketing plans. Checking future plans against past delivery… are they achievable? What if the sales fall by 10%? Then replan and remodel.

We also sometimes use the company’s own external accountants to build the forecasts, then we sanity check.

This process typically takes a week or so of thought from KSA and the board followed up by 4 days of financial forecasting, using a specially designed CVA spreadsheet.

After that every CVA forecast is sanity checked by a KSA director and the nominee. This can lead to delays while we check their veracity and whether they look reasonable and achievable.

Once approved by board, KSA and the nominee they are “burned” into the CVA proposal and the CVA contributions can be finally worked out.

As part of the forecasts we generally get the board to focus on 3 big issues/ numbers

- **Cutting costs**
- **Building sales and margins**
- **Combination of the above**

We recommend you read the KSA costs cutting guide above.

To build amazing forecasts is actually quite easy, BUT ensuring they’re achievable is vital and we would rather see steady, unspectacular sales and margins than “rocket ship forecasts”.

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CVA and director risk, wrongful trading, preferences and the other rules to be aware of.

A man in the pub said to me if your company is insolvent, then this is Wrongful Trading"!

What is Wrongful Trading?

We are often asked what this means because directors have talked to their accountants, advisors, insolvency practitioners or a man in the pub. They may have said "be careful if your company is insolvent then you will be guilty of "wrongful trading"!

Often this is simply not true! The simple explanation is this:
Is the company insolvent? If yes, then the directors must act properly and responsibly. If they do not act properly or the way any reasonable person would have acted, then this may possibly be seen as acting wrongfully.

If wrongful trading is proven, then the directors can be made personally liable for the company's debts from the time they knew the company was insolvent.

The tests for wrongful trading actions include:

1. Not filing confirmation statements for the company at Companies House.

2. Not filing annual or audited accounts at Companies House.

3. Not operating the PAYE scheme correctly, failing to pay PAYE and NIC when due.

4. Not operating the VAT scheme correctly.

5. Taking excessive salaries or expenses/cars when the company cannot afford them.

6. Taking credit from suppliers where there was no "reasonable prospect" of paying the creditor on time.

7. Willfully piling up debt.

8. When in a hole keeping digging!

Please note you don't have to tick all of the above tests to be at risk of wrongful trading!

Formal insolvency procedures

But be aware that wrongful trading only applies in liquidation. Wrongful trading actions can only be commenced after a formal insolvency event. What is a formal insolvency event?

For example Creditors Voluntary Liquidation, Administration, Administrative Receivership or Compulsory Liquidation. It does not apply in Company Voluntary Arrangements.

If your company is insolvent and you know it –

DON'T KEEP DIGGING THE HOLE!

Take advice from us immediately on 0800 9700539

CVA and director risk, wrongful trading, preferences and the other rules to be aware of.

What if there is no insolvency event?

The actions may occur and the company may not enter any formal insolvency. If that happens then be very careful! Keep records of why returns were not filed on time. Write careful minutes of board meetings and shareholders meetings. Keep them safe. In future they may help protect you as a director.

The common sense answer to wrongful trading is – if your company is insolvent and you know it – DON'T KEEP DIGGING THE HOLE! Take advice from us immediately on 0800 9700539.

What does not operating the PAYE/VAT scheme actually mean?

Not paid the deductions of PAYE and NIC across to HM Revenue & Customs? Well, as you will now know that is something that they do not like! Basically, its taxpayers money and the collectors are there to collect it.

HMRC now uses RTI - a central database and can spot slow payments or missed payments much more quickly now.

If your company is not paying PAYE & NIC on time then it is probably insolvent because non payment of tax is a failure to comply with the tax legislation and also signifies (loud and clear) to HMRC that the company is potentially insolvent. So, as directors you need to act properly and deal with this serious threat to your company.

If the company is still viable but just needs breathing space why not propose a time to pay deal? See our guides to time to pay deals or to buy our Experts Time to Pay Programme

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Remember that if the company is insolvent you could be personally liable for the debts, if you continue to trade, whilst doing nothing about the problems that it faces.

Personal Liability

Remember that if the company is insolvent you could be personally liable for the debts, if you continue to trade, whist doing nothing about the problems that it faces. Wrongful trading can be a real problem where ongoing tax arrears are building up and the company and then enters liquidation.

So, act carefully, keep notes of any decisions and always write names of people you speak to at HMRC down. Take advice from experts, above all act promptly as delay may just lead to more problems for you as directors.

What are the Available Options?

Once you have read more about the options on our guide pages like Is our Company Insolvent? Directors Do's and Don'ts and Warning Signs? Then the options you have available are:

1. Time to Pay Deal with Tax and VAT. Why not use our expert programme, written by our MD Keith Steven, we guarantee you'll get a time to pay deal with HMRC or your money back.

2. Trading out, visit this guide to how to deal informally with the problem. This can avoid formal approaches like Voluntary Liquidation, CVA, Compulsory Liquidation and Administration.

3. Some tips…on time to pay deals.

    3.1. Don't wait until legal actions have been taken against the company to ask for a TTP with HMRC

    3.2. Try to plan the cashflow of the business well in advance - you have a legal obligation to do this! If the directors do not think the company has sufficient cash to trade they should consider the obligations and options and plan a way forward.

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Personal Liability cont...

3.3. Don't be too ambitious in planning repayment; you will have bad months as well as good, so be careful with the cashflow forecasts.

3.4. Ask for 18 months to pay back PAYE, knowing that you will probably get 6-9 months at most.

3.5. Ask for 6 months for VAT.

3.6. If your cashflow forecast says you cannot afford that fast a repayment programme, then consider a company voluntary arrangement - CVA.

3.7. We think that, if the company is viable but insolvent, this is the most powerful way of dealing with a serious cashflow problem and tax arrears (which proves insolvency).

2.1. Important tips, HMRC supports well proposed CVA's!
2.2. Secondly, you do not have to pay back all of the debt.
2.3. Thirdly you remain in control.
2.4. Fourthly, the creditors pay for the CVA!

4. Do nothing! Are you serious? Actually this will lead to:

4.1. Bailiffs, High Court Enforcement officers visiting to take assets, Sheriffs, walking possession, distraint and more, much more worry - see here for How to deal with Legal Actions

4.2. Formal insolvency like Creditors Voluntary Liquidation, Administration

So don't risk wrongful trading, it could lead to personal action against you, the loss of your home, your marriage and even bankruptcy

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Having an overdrawn director's current account is actually a breach of the Companies Act 1985/2006.

Directors Overdrawn Current/Loan Accounts?
Why do they matter and what can we do with them?

In more than 75% of our enquiries from directors of struggling companies, we find that this is a major problem, so what is an overdrawn director's current account?

Well, usually the company is making some profits and your accountants advise you to save tax by paying your directors a small salary and then you take dividends from the reserves of profits made in the past and current years. SO off you go taking money out of the business as instructed.

THEN something goes wrong!

Although the advice is generally sound from a tax reduction perspective, when a company is performing well; it's when things go wrong that directors can end up with serious personal liability problems.

Technical Issues

Having an overdrawn director's current account is actually a breach of the Companies Act 1985/2006. All accounts filed at Companies House should refer to any overdrawn current accounts as loans to the director concerned. You must try to get these paid back or reversed in subsequent periods as the HMRC will tax you on a fairly penal rate if you do not.

If the company has no distributable reserves, it cannot pay dividends. So if your company's balance sheet starts a year with nil or negative reserves and if you make no profit you MUST STOP taking dividends as soon as you are aware of this.

It is much better to pay yourselves through PAYE and pay the tax/NIC. If the company cannot afford to pay you GROSS then it is pretty much insolvent.

Having an overdrawn director’s current account is actually a breach of the Companies Act 1985/2006.

Directors Overdrawn Current Accounts cont......

What can we do? Well options include:

- Repay the debt you personally owe to the company.
- Offset any loans the directors have made to the company (this is called set off).
- Take your full salary but reduce the cash you take out of the business to gradually offset the account. So pay yourself £4,000 per month but take £1,000. Remember to pay tax on the £4,000!
- Make a lot of profits in future periods to offset it!
- Use a company voluntary arrangement

What happens in liquidation if we have overdrawn current accounts?

In liquidation the liquidator can demand that directors repay their overdrawn directors current/loan account to the company for the benefit of the creditors. They can take legal action to make directors pay this or even make you bankrupt. So you could lose your house if your director’s current account is overdrawn and not recovered.

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Example Case Study: Directors Overdrawn Loan Account

See if this rings any bells and then call us for help.

Mr. Jones and Mr. Smith set up a limited liability company based in London. It is a design and marketing company and they formed it in 2015.

Sales built quite quickly based upon the contacts in the marketing sector and the company grew to £1.2m sales. Their accountants told them that the company had made £80,000 net profit in year 1 and that this would be taxed for corporation tax purposes at roughly 20%.

So he advised them to leave their PAYE salaries at a lower level each month in year 2 and take dividends from the reserves and future profits.

This they did for a number of years and paid themselves quite well as the company was profitable each year. Then that "something" happened.

Their biggest debtor went bust owing the company c£158,000. Silly to let that debtor take as much credit in my view, but their view was "after all the company was a well known big name customer and we never thought it would fail". And it was good regular business for them so we understand why it got to be such a big debtor.

This led to a situation that was clearly not planned for. In 2019 the company had a bad trading year on top of the failed customer and so had to write the bad debt off. This made a huge loss for the year of £250,000. As a result the balance sheet then became negative and they saw the first flashes of a cashflow crisis looming.

So no further dividends could be taken AND the directors now had overdrawn directors' current accounts to the tune of £27,000 each. With cashflow pressure mounting they came to KSA and said they needed to restructure the company or close it.

This was our advice: consider the options, set out your objectives, look at the viability of the company and then make a decision to ACT. Call KSA in and we will set out the options in writing and in expert detail - that will help you decide.

Call KSA in and we will set out the options in writing and in expert detail - this report will help you make informed decisions.

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Example Case Study:
Directors Overdrawn Loan Account cont....

Stop Options

If the company entered a formal terminal insolvency like administration, voluntary liquidation or compulsory liquidation, then the insolvency practitioner/liquidator could have demanded that the directors repay the £70,000 back to the company for the benefit of creditors.

This could have caused them personal financial hardship and with personal guarantees to the bank of over £200,000 the last thing they wanted to do was liquidation or administration. Indeed it was likely that personal bankruptcy would follow.

Go Options

So we looked at the Go Options with them. (By the way we never charge for this detailed advice) and these included time to pay/trading Out, Trade Sale, CVA and or refinancing.

The key test is viability. We felt that one bad year and a huge bad debt did not equate to a bad business. Far from it this was a good business with dedicated directors and staff. So we said look at Go options and try and select the best option with our help.

We recommended that CVA would be the best solution and this was why.

The overdrawn directors current account liability would be "collected" by the CVA supervisor over a period for the creditors. The company was forecasting a good future profit.

The benefits for trade and tax creditors were that they got a deal paying 55% of their old debt back over 5 years and kept their customer.

The benefits for the company were a downsized business, lower costs; long term survival, no lost contracts and we removed cashflow pressures whilst keeping the bank happy.

The benefits for the directors were that they avoided personal liability, avoided the failure, avoided bank personal guarantees being called up and also they repaid the £27,000 debt to the company over and agreed 3 years in that case.

Plus as owners of the company they have long term employment and a valuable future business.

So if you or your directors have an overdrawn current account and a company that is under real pressure then call us on 0800 9700539. As the above case shows we can save your business and help you as directors.

Buying a company in CVA

It's a good time to buy! The unsecured debt has been tidied up, usually at a discount, and there is a breathing space for investment or acquisition if the seller is willing. Often directors need help from business angels and experienced business people after the CVA is approved.

We often act for shareholders when they wish to restructure the company before selling it. The CVA can drive this process cost effectively.

This guide is not designed to cover this topic but feel free to contact the author if you have a sensible target in mind.

Selling a company in CVA

Having fought a valiant battle many directors want to get out of the CVA mode and look for pasture's a new. Or the board recognises that new capital and management is required to drive the recovery plan. As above it's a good time for investment as the balance sheet is clean and tidy and a well structured CVA can facilitate sale, acquisition or investment.

This guide is not designed to cover this topic but feel free to contact the author if you have a target in mind.

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So the CVA can be used to downsize employment costs and normal contractual obligations. This is powerful stuff and KSA has internal experts who can guide CVA clients through this process.

Employees and CVA's; the process of redundancy in CVA

Using CVA case law (Doorbar) the company can terminate the employment contract of ANY member/s of staff. This is often critical in deciding how to restructure direct costs and overheads.

Step 1: Choose the roles to be made redundant. HOWEVER remember strict rules apply with regards to consultation on redundancy and the timing of said redundancies needs very careful planning with your CVA advisor.

Step 2: Pay the employees to the date they are made redundant, and any holiday pay due.

Step 3: Issue a P45 and ask them to leave immediately, pay their wages and salaries to the exit date.

Step 4: Hand them a letter explaining how they can claim redundancy and lieu of notice payments from the Government. They will need to file an RP1 form so they can claim. NB they cannot claim until the company CVA is approved (which is known as the 'qualifying insolvency event').

Step 5: Get on with the rescue!

So the CVA can be used to downsize employment costs and normal contractual obligations. This is powerful stuff and KSA has internal experts who can guide CVA clients through this process.

HMRC now ranks above claims under the floating charge. This means that in the event of any insolvency process lenders may receive very little and so will be <u>MORE</u> reliant on your personal guarantee if you have granted them one. If you are worried about this call us now.

HMRC secondary preferential creditor status post 1st Dec. 2020

From 1st December 2020 HMRC became a 'secondary preferential creditor' in all forms of UK company insolvency for so called "collected on trust" monies such as PAYE, NIC and VAT.

This means that HMRC ranks behind primary preferential creditors such as employees for £800 each of unpaid wages, but **<u>AHEAD</u>** of the secured creditors (floating charge).

Thus if a company enters liquidation and the liquidator (simply put) sells assets, stock and collects cash that is not subject to a fixed charge collection this money has to be paid (after the cost of the liquidation) to

1) Primary preferential creditors
2) Secondary preferential creditors
3) Prescribed part creditors under the rules
4) Floating charge creditors

You can see a new graphic illustration of this creditors priority here.

This has serious implications for all forms of insolvency events in the UK and may have a damaging effect on future unsecured lending where the lender does not have the primary FIXED charge.

This is a complex rule change and the practical implications on future CVAs need to be carefully considered. From 1986 to 2003 HMRC was in fact a preferential creditor and the author was involved in 100s of successfully proposed CVAs. Most saw HMRC paid 100p in the £1 of dividends from the CVA scheme, with modest payments to unsecured creditors.

Whilst it worked well back then, much has changed in the lending marketplace since. Going forwards most unsecured creditors will receive very small dividends from CVAs where there are large HMRC liabilities. However, remember don't get bogged down in detail as it is our role to help directors navigate these rule changes and to help construct appropriate CVA proposals.

Do contact us on 0800 9077539 to discuss your company or you client's company.

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Summary of the CVA tool
and its' benefits for your company

In our expert opinion, CVAs are the most powerful company rescue tool available in the UK. It's a flexible, far reaching and relatively discrete process done well.

- Terminate unwanted contractual obligations quickly
- Reduce manpower quickly and with NIL CASH COST of redundancy
- Protects the bank borrowing
- No personal risk, personal guarantees usually remain un-called
- Exit or vary the cost of property leases
- Cheaper than administration
- TUPE does not apply
- New money / investment may be ring-fenced from creditors
- Stops legal actions by creditors when approved, (moratorium)
- Time defined process.
- Creative advisors can help you rescue your company with YOU in control.

If this report has helped you understand this superb tool and you think your clients or your company could benefit from the CVA process, call KSA now on 0800 9700539

Visit www.companyrescue.co.uk or email help@ksagroup.co.uk for more information and or to arrange a meeting.

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About the Author

Keith Steven

Keith Steven is a company doctor and turnaround expert. His motto “We save viable businesses; we help you close those that are not”!

Keith is the author of the content of this programme and all of KSA’s web sites. He is managing director of KSA Group - a specialist firm of turnaround and licensed insolvency practitioners.

Keith started his career as a retailer and experienced the savage recession of the 1990’s first hand. This was before the banks had any idea about dealing with SME failures. Close struggling businesses first; ask questions later was the response then. So he learned a lot in a short time and thought "how can we help struggling businesses"?

He joined a specialist insolvency and turnaround firm in London in 1994 and moved on in 1998 to help set up two venture capital companies, specialising in the distressed/turnaround sector. What a great learning curve that was.

KSA started trading in 2000 and the www.companyrescue.co.uk website was launched in 2001 – the world's first website for insolvency and turnaround. It is 20 years old in 2021!

Keith is a former director of the UK Turnaround Management Association and an investor in a number of small businesses.

Contact Keith on 0800 9700 539 or 07833 240747 or by email at keiths@ksagroup.co.uk

Keith will do everything in his power to help your business. As a team at KSA, most of us have been there and know what you are going through.

Afterthought from Keith: "If even a quarter of the people that read this guide chose the CVA path we would see a huge jump in CVA led Company Rescues in the UK: indeed that would lead to over 2,000 CVA's per year. Right now most people don't use the CVA option because of fear of the process and we only see 300-450 annual CVA's in the UK.

Obviously, this guide is generalist, we have many years of hands on CVA experience, and we can assist your company to restructure quickly and professionally. There are lots of ways to turnaround a business and using CVA as the "wrapper" can help limit the time, fees and disruption that all turnarounds suffer from.

If your business needs a rescue, call me or my team.

KSA Group

KSA Group is a national turnaround and restructuring firm.

Corporate Advice

KSA Group explores all options and provides advice on how a distressed business and its stakeholders can improve their financial position.

Finance & Refinance

Whether you need to refinance, replace bank facilities or secure invoice finance, we can help. Our team can arrange a replacement funder in 2-3 days if required.

Turnaround & Insolvency

Our professional team liaises with stakeholders on all insolvency procedures and ensures the best possible outcome under the circumstances.

Lender & Investor Services

We can help lenders by assessing the viability of businesses, using advanced financial forecasting techniques and advising on complex restructuring issues.

Offices in London, Birmingham, Edinburgh. Gateshead, Berwick Upon Tweed.
Tel: 0800 970 0539
Site: www.ksagroup.co.uk

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