



FAMILY LAW, BANKRUPTCY & INSOLVENCY

Abstract

This information booklet has been prepared to explain what happens in proceedings in the Federal Circuit & Family Court of Australia when one of the parties is or becomes bankrupt or where one of the parties is a director of a company/business that becomes insolvent.

Disclaimer:

The information provided is of a general nature only and should not be relied upon. It is not a substitute for legal advice.

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FAMILY LAW, BANKRUPTCY & INSOLVENCY

Introduction:

The relevant legislation is the Bankruptcy Act 1966 (Cth), Corporations Act 2011 (Cth) and the Family Law Act 1975 (Cth)

Crucial amendments have been made to the Bankruptcy Act 1966 (Cth) and the Family Law Act 1975 (Cth) with respect to property settlement proceedings in matrimonial matters. They apply equally to people who were in de facto relationships.

Pursuant to Section 58 of the Bankruptcy Act 1966 (Cth), all property held by a bankrupt person, or was acquired by him or her during the bankruptcy vests in the Trustee for Bankruptcy. A right to litigate does constitute property as that right is a personal right. However, the property of the relationship is vested in the Trustee of Bankruptcy, who has the right to be heard in the property settlement proceedings.

Section 60 of the Bankruptcy Act 1966 (Cth) states that where an action has been commenced by a party for property settlement, under the Family Law Act 1975 (Cth), the proceedings must be stayed until the Trustee in Bankruptcy makes an election, in writing, to prosecute or discontinue the action.

Bankruptcy occurs when a person cannot pay their bills. It is called insolvency when a business is unable to pay their bills as and when they fall due – section 95A Corporations Act 2001 (Cth).

Bankruptcy Act 1966 (Cth)

1. The Bankruptcy Act 1966 provides for the vesting of property in the Trustee upon the commencement of bankruptcy. As this is a Commonwealth Act, it applies throughout Australia. The government agency responsible for administration the legislation is the Australian Financial Security Authority.
2. Vesting of property means that the Trustee becomes the owner of the property and can deal with it, for the benefit of the bankrupt estate.

What is bankruptcy and the period of bankruptcy?

Bankruptcy is a legal process where a person is declared unable to pay his/her debts. It can release you from most debts, provide relief and allow you to make a fresh start. A person as able to into 'voluntary bankruptcy'. To this he or she will need to complete and submit a Bankruptcy Form. It is also possible that someone you owe money to – a creditor – can make you bankruptcy through a court process, known as a sequestration order.

Bankruptcy normally lasts for a period of **3 years and 1 day**.

Corporations Act 2001 (Cth)

Only people can be made bankrupt (not companies). Companies cannot become bankrupt under the Bankruptcy Act 1966 (Cth). Companies are wound up or liquidated under the Corporations Act 2011 (Cth) for insolvent trading.

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Where there is a partnership, all or a majority of the partners in the business file for bankruptcy. If a majority of the partners, do this, any other partners will have to take action to avoid also being declared bankrupt. A spouse or de facto partner who has debts that they cannot pay, can be made or can become bankrupt. Normally, this will have no effect upon the spouse or de facto partner, provided they are not a guarantor or jointly liable for the debt, in which case, the creditor, will usually require that he or she pay the total debt, or the remainder of the debt owing.

What are the obligations of the bankrupt person?

1. You must provide details of your debts, income and assets to your Trustee.
2. Your Trustee notifies your creditors that you are bankrupt. This prevents most creditors from contact you about your debt:
3. Your Trustee can sell certain assets to help pay your debts.
4. You may need to make compulsory payments. If your income exceeds a set amount:
[Indexed amounts | Australian Financial Security Authority \(afsa.gov.au\)](https://www.afsa.gov.au/indexed-amounts).

Duties of Directors under the Corporations Act 2001 (Cth):

The duties of the director or directors of a company are stated in sections 180 to 185 of the Corporations act 2001 (Cth). The duties require the director(s) to:

1. Exercise care and diligence for the benefit of the business and not themselves and seek information from other sources such as accountants to facilitate and optimise the well-being and solvency of the business – Section 180.
2. To at all times act in good faith for the benefit business and not to enrich or otherwise benefit themselves – Section 181.
3. To use the position of director for the benefit of the business, so as not to cause it any detriment – Section 182.
4. To use information that comes to hand, for the benefit of the business – Section 183.
5. To act in good faith, to use their position as director and to use information that benefits the business, so as not to cause it any detriment – Section 184 is the criminal provision.
6. To prevent insolvent trading by the business – Section 588G.

What are the obligations of the Director or Directors when the business is in liquidation?

Directors have an obligation to assist the liquidator. They must:

- advise the location of the company's property and delivering the property in their possession to the external administrator or receiver
- provide the company's books and records or giving access to the books and records to the receiver
- advise where other company records are held
- provide a Report on Company Activities and Property (ROCAP) within five business days (creditors' voluntary liquidation and voluntary administration) or 10 business days

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(receivership and court liquidation) of the external administrator or receivers' appointment

- meet with, or report to, the external administrator or receiver to help them with their inquiries, as reasonably required.

Directors, officers and other people with relevant books and records must not obstruct external administrators and receivers in carrying out their duties.

Definition of property under the Bankruptcy Act 1966 and Protected Property:

This is defined in section 116(2) of the Bankruptcy Act 1966.

Property means real or personal property of every description, whether it is in Australia or elsewhere. It includes any estate, interest or profit, whether present or future, vested or contingent arising out of or incidental to any such real or personal property.

All personal property owned at the date of bankruptcy, or that the bankrupt acquires or that devolves upon the bankrupt before the discharge of the bankruptcy vests in the Trustee unless the property is specifically protected pursuant to section 116(2) of the Bankruptcy Act 1966. Protected property, is property that a bankrupt person is allowed to keep: [Treatment of property in bankruptcy | Australian Financial Security Authority \(afsa.gov.au\)](#)

1. The following protected property is provided for in subsection 116(2):
 1. Those ordinary household items specified in section 27 of the Bankruptcy Regulations. These items include kitchen equipment, certain furniture and certain electronic appliances
 2. Property held in trust for someone else
 3. Property of the bankrupt that has sentimental value, where creditors vote to let the bankrupt keep the specific property
 4. Property of the bankrupt used by the bankrupt in earning income, up to the limit prescribed in the Bankruptcy Regulations
 5. Property of the bankrupt used primarily as means of transport, up to the limit prescribed in the Bankruptcy Regulations
 6. Life insurance policies
 7. Any balance the bankrupt has in a regulated superannuation fund
 8. Certain payments received pursuant to the Family Law Act 1975
 9. In certain circumstances, the right of a bankrupt to recover damages or compensation and some types of compensation received (more information about compensation is contained.
 10. Amounts paid under certain government schemes.

Property of the business:

The property of the business is the equipment that the business owns and uses in the day to day running of it. These assets are available to the Liquidator to

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The Family Law Act 1975 (Cth): Sections 79, 79A

These sections give the Federal Circuit and Family Court of Australia, authority to hear and to determine and where necessary make orders altering the property interests of the party in property settlement matters where bankruptcy is a feature of the proceedings.

The Family Law Act 1975 (Cth) has **equivalent provisions**, allowing the Federal Circuit and Family Court of Australia to deal with property settlement matters involving parties who were in **de facto relationships** where bankruptcy is a feature in the matter or during the proceedings becomes a feature in the proceedings.

Sections 79 of the Family Law Act 1975 (Cth)

Section 79 permits the alteration of property interests between the parties. It states:

- (1) In property settlement proceedings, the court may make such order as it considers appropriate:
 - (a) In the case of proceedings with respect to the property of the parties to the marriage or either of them – altering the interests of the parties to the marriage in the property, or
 - (b) In the case of proceedings with respect to the vested bankruptcy property in relation to a bankrupt party to the marriage – altering the interests of the bankruptcy trustee in the vested bankruptcy property; including
 - (c) An order for a settlement of property in substitution for any interest in the property and
 - (d) An order requiring:
 - (i) Either or both of the parties to the marriage; or
 - (ii) The relevant bankruptcy trustee (if any) to make, for the benefit of either or both of the parties to the marriage or a child of the marriage such settlement or transfer of property as the court determines.
- (1A) An order made under subsection (1) in property settlement proceedings may after the death of a party to the marriage be enforced on behalf of, or against, as the case may be, the estate of the deceased party.

Section 79(1)(11) provides for the involvement of the bankruptcy Trustee in the property settlement litigation to the extent that the litigation involves vested bankruptcy property and where an application is made for property settlement involving a bankrupt party, the bankruptcy Trustee should be joined to the proceedings.

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Section 79A of the Family Law Act 1975 (Cth)

Section 79A of the Family Law Act 1975 (Cth) authorises the Federal Circuit and Family Court of Australia to set aside orders where property interests have been altered. The party who wishes to claim that this should occur must file an application, asking for this to occur.

Relevant considerations here would be:

1. Where there has been a miscarriage of justice by reason of fraud, duress, suppression of evidence (including a failure to disclose relevant information), the giving of false evidence or any other circumstances – Section 79A(1)(a).
2. In circumstances that have arisen since the order was made making it impracticable for the order to be carried out or impracticable for a part of the order to be carried out – Section 79A(a)(b).
3. A person has defaulted in carrying out an obligation imposed on the person by the order and in the circumstances that have arisen as a result of that default, it is just and equitable to vary the order or to set the order aside and make another order in substitution for the order – Section 79A(1)(c).
4. In the circumstances that have arisen since the making of the order being circumstances of an exception nature relating to the care, welfare and development of a child of the marriage, the child or where the applicant has caring responsibility for the child, the applicant will suffer hardship if the court does not vary the order, or set it aside and make another order in substitution of the order – Section 79A(1)(d).

The jurisdiction of the Federal Circuit and Family Court of Australia where the Trustee in Bankruptcy or a Liquidator is a party to the property settlement proceedings:

Sections 35(1) and 35(1A) of the Bankruptcy Act 1966 (Cth) permits the Federal Circuit and Family Court of Australia to hear, determine and make orders including altering the property interests, where at a particular time a party to the marriage or de fact relationship is bankrupt and the Trustee of the bankrupt estate is a party to the property settlement proceedings. Where the parties seek to execute Consent Orders to evade or thwart the interests of creditors or the Trustee in bankruptcy, the Consent orders can be set aside.

Matrimonial cause is defined in section 4 of the Family Law Act 1975 (Cth) as a party to a marriage and the bankruptcy Trustee of a bankrupt party to the marriage. All matrimonial property that is the subject of bankruptcy vests with the Trustee. Accordingly, no property can be dealt with, in any manner, without the consent of the Trustee in Bankruptcy.

The same occurs with respect to companies in liquidation. The Liquidator has a right to be heard.

What happens when a party to property settlement proceedings, pursuant to the Family Law Act 1975 (Cth) becomes bankrupt during them?

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There is case law on this issue. In Sloan & Sloan [2018] FamCA 610, the husband became bankrupt during proceedings for parenting and property settlement. The issue for the court to decide was whether or not the husband could continue with his application, for parenting and property settlement orders, which were commenced before he became bankrupt. Justice Gill held that the right to litigate family law property proceedings does not vest in the Trustee because such a right is personal to the bankrupt person, except where the proceedings affect the quantum of the estate of the bankrupt person. Practically, what this means, is that while a bankrupt spouse, may commence proceedings, under the Family Law Act 1975 (Cth), any property settlement obtained by him or her, will become the property of the bankruptcy Trustee and be applied to meet the debts of the bankrupt person.

Section 60 of the Bankruptcy Act 1966 (Cth): Stay of Legal Proceedings:

This section provides that civil legal proceedings, commenced by an individual who then becomes bankrupt, are stayed – not continued – until the Trustee in Bankruptcy advises of his or her decision in writing regarding whether the action will remain on foot or be discontinued. The Trustee must make his election without 28 days of receipt of notice of the action from the other party to the proceedings. If there is no election made by the Trustee in Bankruptcy, the court deems that the Trustee in Bankruptcy has abandoned the action. It is usual for a Trustee in Bankruptcy to become a party to family law proceedings as there is an obligation on the part of the Trustee in Bankruptcy to protect the rights of the creditors for payment of their debts. In this matter, the Trustee in Bankruptcy directing that the family law proceedings in relation to property settlement continue. The Trustee in Bankruptcy does not become a party to parenting proceedings. They continue between the parents only.

In the matter of O'Neill [1998] FamCA 57, a similar outcome occurred. Their Honours Justices Lindenmeyer, Finn and Mushin, of the Full Court of the Family Court, held that a bankrupt spouse may initiate and prosecute proceedings for property settlement orders during the course of bankruptcy, however, pursuant to section 58(1)(b) of the Bankruptcy Act 1966 (Cth), any property acquired would vest in the Trustee in Bankruptcy, except for a limited class of exempt property.

It is the same where a company is in liquidation.

Notice of Proceedings to the Trustee in Bankruptcy: Federal Circuit & Family Court of Australia (Family Law) Rules 2021 (Cth) in Part 3.6.

The party who becomes bankrupt and the party who becomes aware that their spouse or de facto partner has become bankrupt **must** serve notice of the proceedings on the Trustee in Bankruptcy pursuant with Rule 3.2 of the Federal Circuit and Family Court of Australia (Family Law) Rules 2021 (Cth) and in the manner prescribed by Rule 3.22

If you find out that your spouse has been declared bankrupt you should immediately seek legal advice. The bankruptcy event is likely to have a significant impact on the property settlement proceedings and the ability to negotiate a settlement. The Trustee in Bankruptcy has the right to have a say in the outcome of the property settlement negotiations and orders. If this does not occur, the Consent Orders negotiated between the parties can be set aside. The rights of the creditors of the bankrupt party, cannot be defeated, by way of a negotiation between you and your spouse.

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Property of Trustee in Bankruptcy and right of the bankrupt person to commence litigation:

Section 58 of the Bankruptcy Act 1966 provides that the property of the bankrupt person, being his or her assets in his or her possession at the time when he or she is bankrupt and during the period of bankruptcy, vests with the Trustee in Bankruptcy.

The ability to litigate when you a bankrupt person is limited. If the Trustee is not joined or does not seek to participate in the proceeding, the proceeding will continue without the Trustee. If, however, the Trustee elects to continue, or is joined to, the proceeding:

The bankrupt spouse loses his or her right to:

1. Make submissions to the Court in relation to the assets that have vested in the Trustee in Bankruptcy, and
2. Consent to any court order made in relation to the assets that have vested in the Trustee in Bankruptcy.
3. However the Trustee in Bankruptcy and the non-bankrupt spouse may make submissions to the Court and finalise the property settlement proceedings by way of Consent orders, in relation to the assets that have vested in the Trustee in Bankruptcy.
4. The bankrupt spouse retains the right to make submissions to the Court, with respect to any assets that have not vested in the Trustee in Bankruptcy.

When making a final court order, the Federal Circuit and Family Court of Australia, is required to take into account the effect of any order made, on the ability of creditors to recover their debts. However, the creditor's interests, do not take priority over the interest of a non-bankrupt spouse. Accordingly, the court can make an order to transfer property to a non-bankrupt spouse, even if it would result in the Trustee being unable to pay any or all of the bankrupt's creditors.

Notwithstanding this, historically the courts have determined that it would not be just and equitable, or in other words, fair or reasonable, for a non-bankrupt spouse, or de fact partner, to receive a direct or indirect financial benefit from the wrongdoing of the bankrupt spouse. The court has a difficult task, where it must balance the legal entitlements of the non-bankrupt spouse or de fact partner and the impact to the children on one hand and the third party creditors, represented by the Trustee in Bankruptcy on the other.

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APPENDIX A: Federal Circuit & Family Court of Australia (Family Law) Rules 2021 (Cth)

Part 3.6 – Death or Bankruptcy of a Party

Division 3.6.2 Bankruptcy or Insolvency of Party

In this Division:

Bankruptcy proceedings means proceedings under the Bankruptcy Act in the Federal Court of the Federal Circuit and Family Court of Australia, (Division 2) in relation to:

1. The bankruptcy of a relevant party, or
2. The relevant capacity of a Party as a Debtor subject to a personal insolvency agreement.

Relevant party means a person who is:

1. A party to a marriage or de facto relationship, or
2. A party to a relevant proceeding in relation to that marriage or de facto relationship.

Relevant proceeding means any of the following:

1. A pending proceeding under sections 66G, 66S, 74, 78, 79 79A, 83, 90SE, 90SL, 90SM or 90SN of the Family Law Act 1975 (Cth)
2. A pending proceeding under Division 4 or Division 4 or 5 of Part 7 of the Assessment Act,
3. A pending proceeding for enforcement of an order made under a provision referred to in paragraph (1) or (2), in this section.

Rule 3.21 Notice of bankruptcy or personal insolvency agreement

1. If a relevant party is also a bankrupt or a debtor subject to a personal insolvency agreement, that party must notify:
 - (a) All other parties to the relevant proceedings, in writing about the bankruptcy or personal insolvency agreement; and
 - (b) The bankruptcy trustee or the trustee of the personal insolvency agreement, as the case may be, about the relevant proceeding in accordance with rule 3.22 and
 - (c) The court in which the relevant proceeding is pending, in accordance with Rule 3.23.
2. A party may apply for procedural orders for the future conduct of the proceeding.

Rule 3.22 Notice under paragraph 3.21(1)(b)

For the purpose of paragraph 3.21(1)(b), notice to a bankruptcy trustee or a trustee of a personal insolvency agreement must:

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1. be in writing; and
2. be given within 7 days, or as soon as practicable, after the date on which the party becomes both
 - a. a relevant party, and
 - b. a bankrupt or debtor and
 - c. attach a copy of the application stating the relevant proceeding, response (if any) and any other relevant documents, and
 - d. state the date and place of the next court event in the relevant proceeding.

Rule 3.23 Notice under paragraph 3.21(1)(c)

3.23 Notice under paragraph 3.21(1)(c)

For the purposes of paragraph 3.21(1)(c), notice to the court must:

1. Be in writing, and
2. Be given within 7 days, or as soon as practicable, after the date on which the party becomes both:
 - (a) A relevant party; and
 - (b) A bankrupt or debtor and
 - (c) Attach a copy of the notices given in accordance with paragraphs 3.21(1)(aa) and (b).

Rule 3.24 Notice of Bankruptcy proceedings

1. If a relevant party is a party to bankruptcy proceedings, the party must give notice of the bankruptcy proceedings to the court in which the relevant proceeding is pending and to the other party or parties to the proceedings.
2. The notice must:
 - (a) Be in writing and
 - (b) Be given within 7 days, or as soon as practicable, after the date on which the party becomes a party to bankruptcy proceedings and
 - (c) State the date and place of the next court event in the bankruptcy proceedings.

Rule 3.25 Notice of application under section 139A of the Bankruptcy Act 1966 (Cth)

1. If the bankruptcy trustee of a bankrupt party to a marriage or de facto relationship has applied under this section for an order ... and the trustee knows that a relevant proceeding in relation to the bankrupt party is pending in a court exercising jurisdiction under the Family Law Act 1975 (Cth) the trustee must notify:

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- (a) The court exercising jurisdiction under the Family Law Act 1975 (Cth) in the relevant proceeding, and
 - (b) If the bankruptcy trustee's application relates to an entity other than the other party to the marriage or de facto relationship – the other party to the marriage or de facto relationship.
2. For the purposes of paragraph (1)(a), a notice to the court must:
- (a) Be in writing, and
 - (b) Be given within 7 days, or as soon as practicable, after the bankruptcy trustee makes the application under section 139A of the Bankruptcy Act 1966 (Cth) and
 - (c) State the date and place of the next court event in the proceedings under section 139A of the Bankruptcy Act 1966 (Cth).
3. For the purposes of paragraph (1)(b), notice to the other party to the marriage or de facto relationship must:
- (a) Be in writing, and
 - (b) Be given within 7 days, or as soon as practicable, after the bankruptcy trustee makes the application under section 139A of the Bankruptcy Act 1966 (Cth) and
 - (c) Attach a copy of the application, other initiating process and any other relevant documents, in the application under section 139A of the Bankruptcy Act 1966 (Cth) and
 - (d) State the date and place of the next court event in the proceedings under section 139A of the Bankruptcy Act 1966 (Cth)

Rule 3.26 Official name of trustee

1. If a bankruptcy trustee or a trustee of a personal insolvency agreement is added as a party to a relevant proceeding, the trustee must be added using the prescribed official name of the trustee.
2. In subrule 1:

Prescribed official name of the trustee has the meaning given by:

- (a) For a bankruptcy trustee – subsection 161(2) of the Bankruptcy Act 1966 (Cth) of
- (b) For a trustee of a personal insolvency agreement – subsection 219(2) of the Bankruptcy Act 1966 (Cth)

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APPENDIX B: Consequences of Insolvent Trading

Consequences of insolvent trading

There are various penalties and consequences for insolvent trading, including civil penalties, compensation proceedings and criminal charges.

The Corporations Act provides some statutory defences for directors. However, directors may find it difficult to rely on these if they have not taken steps to stay informed about the company's financial position.

Civil penalties

Contravening the insolvent trading provisions of the Corporations Act can result in civil penalties against directors, including pecuniary penalties of up to \$200,000.

Compensation proceedings

Compensation proceedings for amounts lost by creditors can be initiated by ASIC, a liquidator or a creditor against a director personally. A compensation order can be made in addition to civil penalties.

Compensation payments are potentially unlimited and could lead to the personal bankruptcy of directors. The personal bankruptcy of a director disqualifies that director from continuing as a director or managing a company.

Criminal charges

If dishonesty is found to be a factor in insolvent trading, a director may also be subject to criminal charges (which can lead to a fine of up to 2,000 penalty units or imprisonment for up to five years, or both). Being found guilty of the criminal offence of insolvent trading will also lead to a director's disqualification.

ASIC has successfully prosecuted directors for allowing companies to incur debts when the company is insolvent – and has sought orders making directors personally liable for company debts.

The good news is that taking steps to ensure your company remains financially sound will minimise the risk of an insolvent trading action against you. It may also improve your company's performance.

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APPENDIX C: Tips for Directors of Companies in Financial Difficulty

What to do if you suspect financial difficulty in the business

If you suspect your company is in financial difficulty, get professional accounting and/or legal and or accounting advice as early as possible. This increases the likelihood the company will survive. Do not take a 'head in the sand' attitude, hoping that things will improve – they rarely do. Warning signs of insolvency include:

- ongoing losses
- poor cash flow
- absence of a business plan
- incomplete financial records or disorganised internal accounting procedures
- lack of cash-flow forecasts and other budgets
- increasing debt (liabilities greater than assets)
- problems selling stock or collecting debts
- unrecoverable loans to associated parties
- creditors unpaid outside usual terms
- solicitors' letters, demands, summonses, judgements or warrants issued against your company
- suppliers placing your company on cash-on-delivery terms
- special arrangements with selected creditors
- payments to creditors of rounded sums that are not reconcilable to specific invoices
- overdraft limit reached or defaults on loan or interest payments
- problems obtaining finance
- change of bank, lender or increased monitoring/involvement by financier
- inability to raise funds from shareholders
- overdue taxes and superannuation liabilities
- board disputes and director resignations, or loss of management personnel
- increased level of complaints or queries raised with suppliers
- an expectation that the 'next' big job/sale/contract will save the company.