Ensors Chartered Accountants

Making you more than just a number

We will be using the interactive service Slido, please visit Slido.com and enter code – 3776 764

Fit for Recession?

12th January 2023

Mark Upton · Steven Law · David Scrivener

Ensors Chartered Accountants

Making you more than just a number

Mark Upton

Business Recovery & Insolvency Partner

LinkedIn Mark Upton

Email Mark.upton@ensors.co.uk

Steven Law

Consultant

LinkedIn Steven Law

Email Steven.law@ensors.co.uk

David Scrivener

Corporate Finance & Restructuring Partner

LinkedIn David Scrivener

Email David.scrivener@ensors.co.uk

@EnsorsBusRec

Introduction – Steven Law

- Introductory comments
- We will be using the interactive service Slido, to have your say in our polls, please visit Slido.com and enter code – 3776 764
- Or please scan QR Code on screen

Do you think that it is inevitable that the UK economy will fall into recession during 2023?

ⓘ Start presenting to display the poll results on this slide.

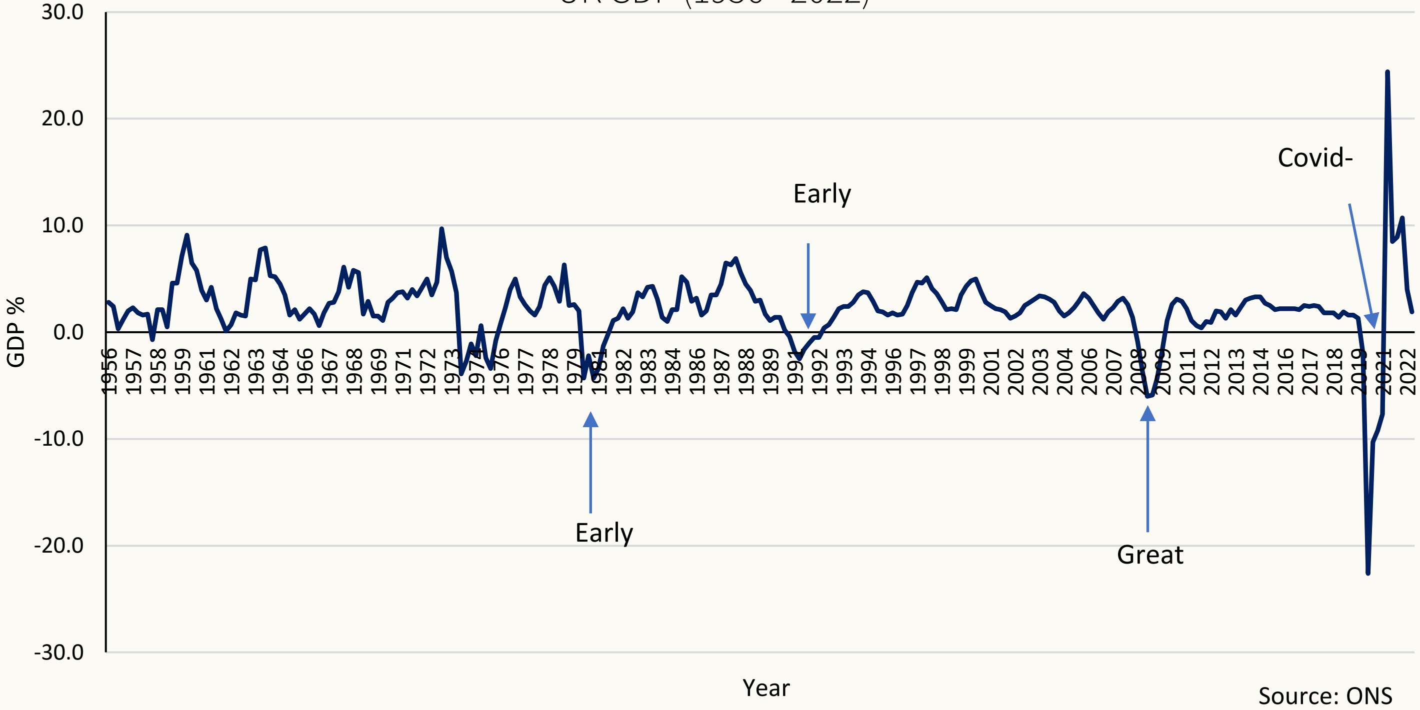
In order of threat to your clients' businesses, which of these do you think will present the most significant challenge during 2023?

ⓘ Start presenting to display the poll results on this slide.

Ensors Chartered Accountants

Making you more than just a number

UK GDP (1956 - 2022)

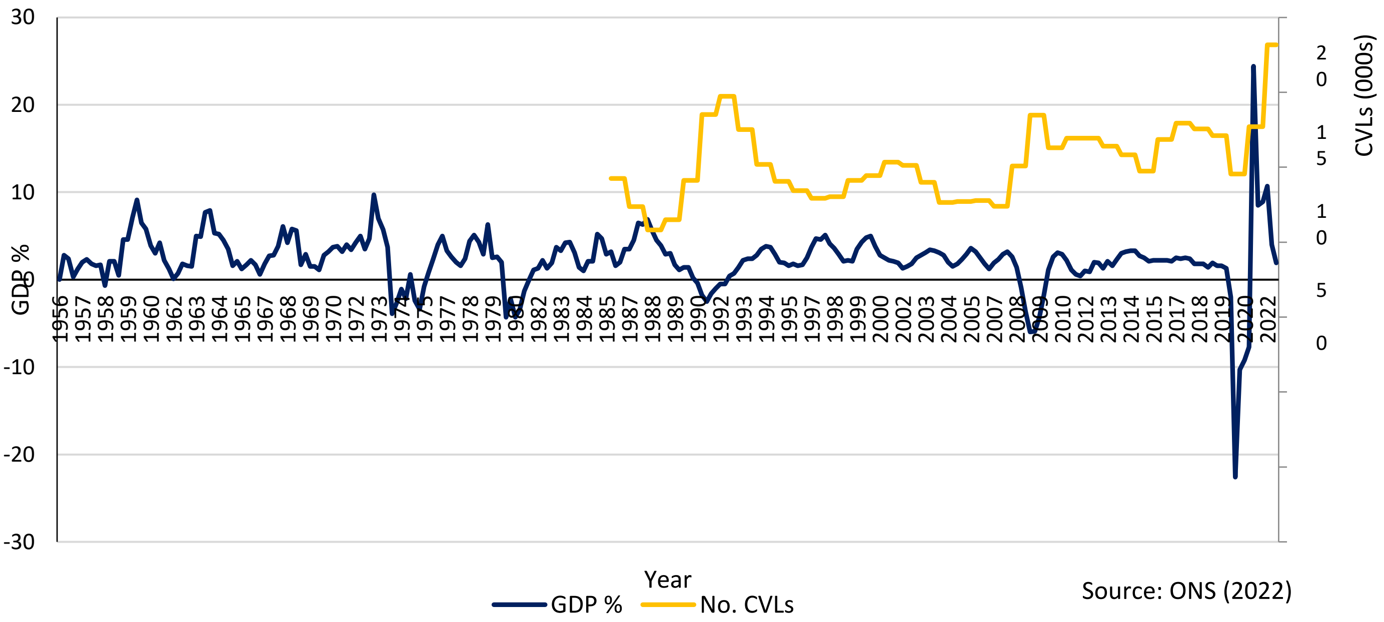


Source: ONS

Ensors Chartered Accountants

Making you more than just a number

UK GDP & CVLs (1956 - 2022)



Source: ONS (2022)

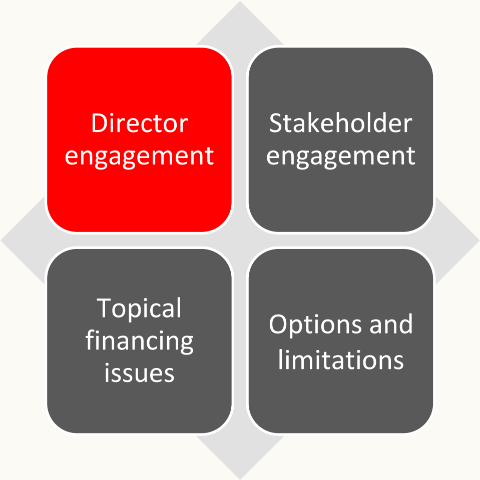
Four key areas of focus – Fit for Recession

Director engagement (with an IP) - overview

- Director **engagement is key**.
  Extremes
  - Really worried – early engagement
  - Couldn't care less - late engagement
- Is the Company **insolvent**?
- Can we carry on **trading**?
- What does that **mean for me**/the board?
  - Financial
  - Disqualification

Director engagement – initial contact and advice

Don’t panic, be proportionate – taking timely professional advice is so important. It gives the most amount of time to devise a plan to rescue the business. Don’t let directors bury their heads in the sand



- Early engagement preferred, obviously
- Directors need to keep a balanced approach however
- Taking too cautious a view can actually lead to worse outcome and increase risk
- Over reliance on internet research… or the guy down the pub
- Our role is often to reassure directors where appropriate. Focus on recovery actions (refinance, negotiation etc). Work with stakeholders
- Directors need to make sure the issue is shared with the entire board. This is not just the FD or MD’s problem

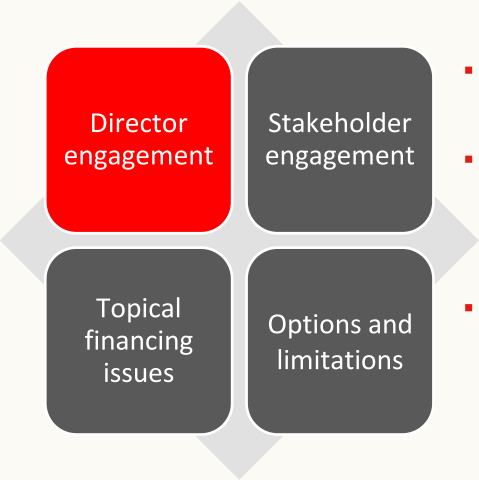
Director engagement – is the company insolvent?

Need good accounting data to make accurate assessment– up to date management accounts and operational short term cash flow forecasts are essential in defining insolvency and planning rescue options

- Highly subjective area – s. 123 IA helpful but practically have to consider multiple factors
- Recently we have seen examples:
  - ✓ Very profitable company that is over leveraged
  - ✓ Balance sheet deficit without creditor pressure (e.g. shareholder loan)
  - × Every type of secured and unsecured debt taken up in desperation
- Each case stands on own merits. Is there a way out that is reasonable? And, if so, how will it be funded?

Director responsibilities – can we carry on trading?

Just because a company is struggling, it doesn't always signal the end – there are many reasons that carrying on for a short period of time may be beneficial. Have to be advised however and need the buy in of funders and any other key creditors.



- Yes. As long as position is not worsened as a result
- Why? To aid rescue or to deliver a better outcome for creditors. Usually down to timing
- Beware s.214 (wrongful trading) but don't be blindsided by it in most cases. Taking sensible and timely steps to improve creditor returns or rescue the company is unlikely to be criticised
- Look at the detail – can we mitigate creditor positions by:
  - Paying upfront (e.g. supplier orders)
  - Ringfencing (e.g. customer deposits)
  - Considering timing? (e.g. seasonality)
- Ultimately the ability to carry on will be determined by funding/key stakeholders (funders, landlords, HMRC)

Director engagement – what does this mean for me?

Recording rationale and actions is key – it is much better to have a contemporaneous record of what was advised/actions taken rather than rely on memory. Minutes and file notes essential. As financial pressure mounts consider conduct carefully.

Director engagement

Stakeholder engagement

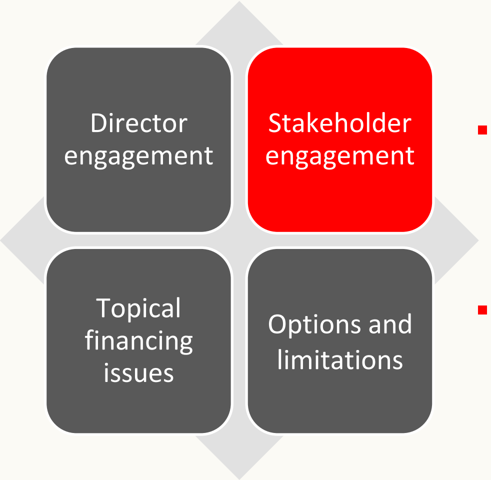
Topical financing issues

Options and limitations

- Ultimately directors are at risk financially (personally) if breached duties/IA
- Also, at risk of disqualification so beware of higher risk areas:
  - BBL/CBIL misuse (examples later)
  - Consumer monies (B2C business)
  - Public interest (Regulated, B2C, client monies)
- Seeing successful business owners drawn into these situations. Limited liability concept is not well understood
- Rarely black and white for directors in terms of liability or conduct. Take advice if unsure

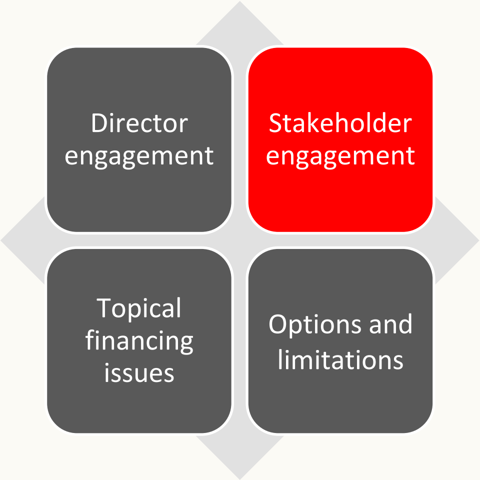
Stakeholder engagement

Don't make decisions based on fear of what you think stakeholders might do. Communication and early engagement will often be key and all stakeholders will have an interest in the business surviving or finding the optimum exit.



- Default position of Directors is generally not to engage through fear of adverse reaction
- Our view is that full and early engagement is often crucial
  - Increases options
  - Nobody likes surprises
- Everybody that you deal with is a stakeholder but key ones are
  - Funders
  - HMRC
  - Landlords
  - Key creditors
  - Employees

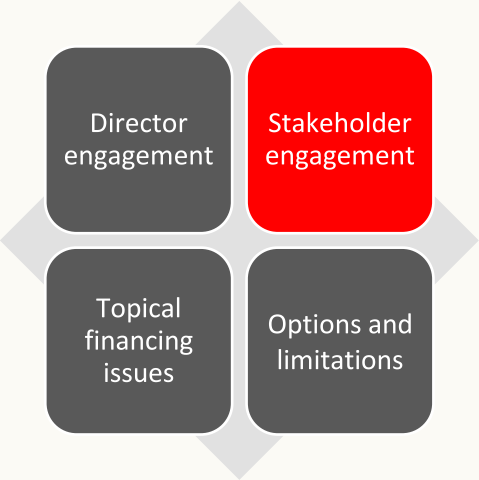
Stakeholder engagement - Funders



- ‘But if we tell them that then they will withdraw our funding and that will be the end of the business!’
- What are funders looking for?
  - Clarity
  - Reliable financial information
  - A strategy and plan
  - Options
  - No surprises

Stakeholder engagement - Funders

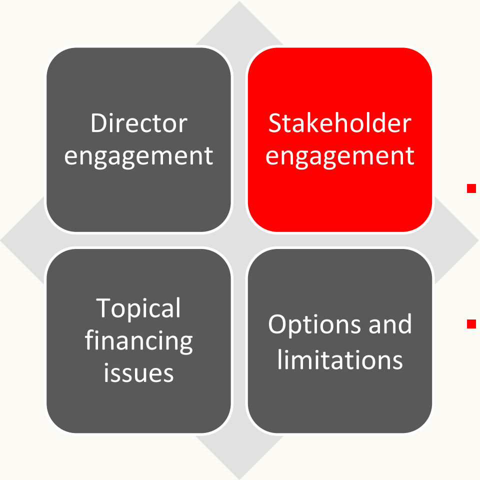
Funders will support wherever they can but we need to be realistic in assessing options and outcomes. This will in part depend on where the business is on the distress curve and the prospects of recovery but also on the relationship (trust) between management and funder.



- Example 1
  - Early engagement with full disclosure and illustration of options and exit scenarios led to continued support and write off of debt
- Example 2
  - Initial reluctance / inability to provide full information resulted in funding issues and cooling of existing relationship. We were able to stabilise and introduce new funders.

Stakeholder engagement - HMRC

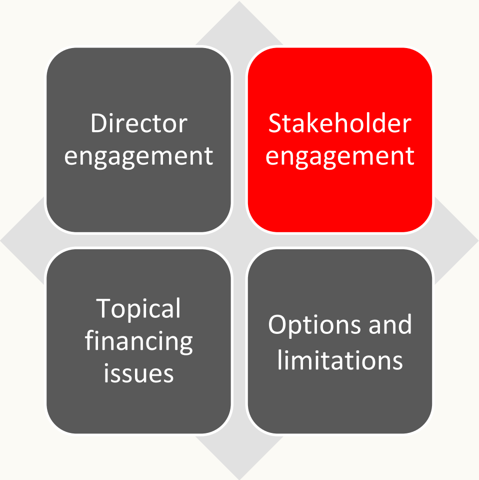
HMRC's systems and data collection are much improved and non payment of taxes is more readily identified and acted upon. They are though prepared to agree extended payment plans rather than pursue winding up petitions but react badly to lack of communication and defaulting on agreed arrangements without explanation.



- HMRC have expressly stated that they require businesses to tell them if they are struggling to pay taxes and to communicate with them if that is the case
- Lack of communication will lead to quicker recovery default action by HMRC ie Winding Up Petitions
- There is no 'standard' Time to Pay arrangement but failure to keep to it or advise HMRC will make any revised arrangement difficult.
- Impact of Preferential Creditor status and need to collect tax

Stakeholder engagement - Landlords

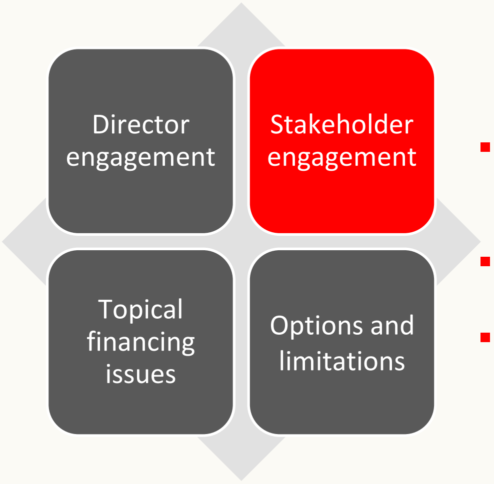
Landlords had been unable to take any recovery action during Covid and may well be under financial pressure themselves as a result. There may therefore be an opportunity to negotiate terms but landlords will require some certainty that rent will be paid going forward. Good financial information and early communication are therefore, again, key.



- We do often find that engagement and communication with landlords is better advanced than with other stakeholders
- Landlord powers and recovery action had been diluted during Covid but now most restrictions have been lifted other than in relation to rent due during a ‘protected period’
- Opportunity to re- negotiate terms and cut costs or at least defer rent payments?

Stakeholder engagement – Creditors / Suppliers

Dealing with creditors and suppliers in a distressed situation can be tricky. How creditors and suppliers will react can be unpredictable so any approach and negotiation should only be considered if there is a strong relationship and / or good understanding of the potential outcomes and options for the creditor / supplier.



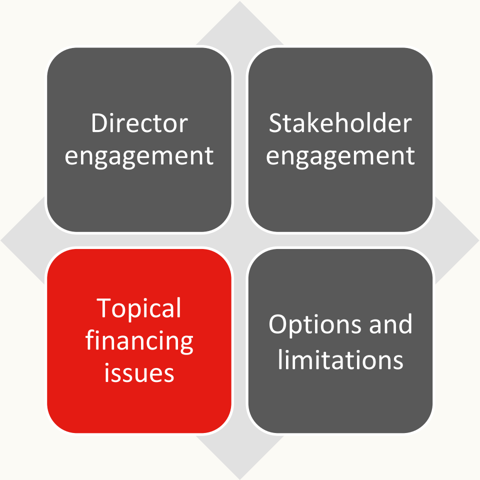
- Your suppliers want your business to survive (but they are going to be mindful of the impact on their own business)
- Negotiations can be difficult as generally on the back foot
- Don’t over promise
- Impact on cashflow and working capital
  - Deferment
  - Up front payment
  - Potential for sudden withdrawal of supply so do we have alternatives?

Stakeholder engagement – Employees

Who and when management bring employees into any discussions is always difficult to judge and there is an understandable reluctance from management to do so. But remember employees have a clear interest in the business surviving and could make significant contributions.

- Don't kid yourself that they don't know what is going on!
- Will need at some point to bring key employees into the loop
- Salary deferrals or reductions for Directors
- Positive spin if you can
  - Where can we cut costs?
  - New ideas to make the business more efficient
  - Wider employee engagement
- But clearly need to exercise caution

Topical financing issues



CBIL and BBL misuse

Barber jailed over misuse of bounce back loan

Barber jailed for 12 years after sending thousands of pounds from bounce back loans to Islamic State in Syria

Clothes wholesaler banned for £50k bounce back fraud

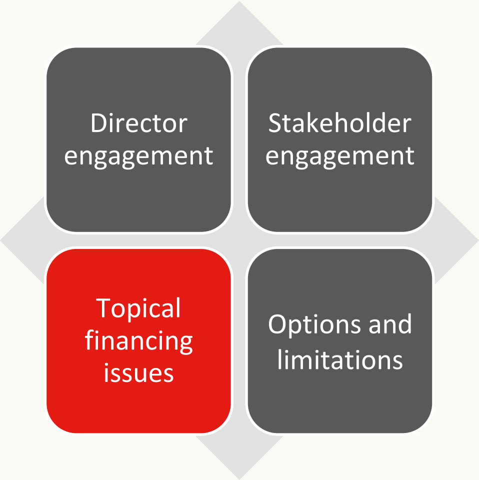
A clothing trader has been banned for 10 years after falsely claiming £50,000 bounce back loan

Financial Times

'A giant bonfire of taxpayers' money': fraud and the UK ...

BBL/CBIL misuse

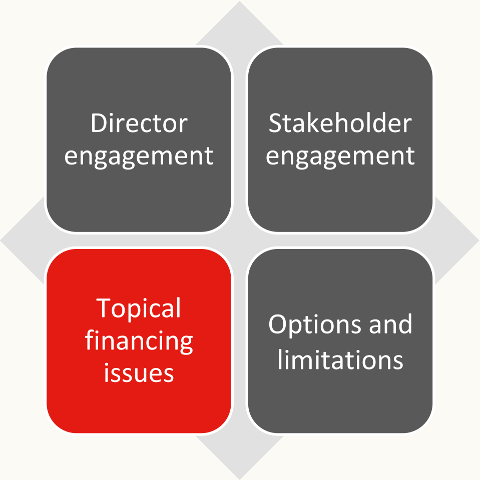
Can misuse be rectified? This obviously depends considerably on the quantum and intention of those that may be guilty. If something looks optically wrong (e.g. onward finance to connected company), can it be repaid/accounted for?



- Bounce Back Loans (BBL) and Coronavirus Business Interruption Loans (CBIL). Don't forget context. £78bn lent (around 1/3rd expected never to be recovered)
- "Misuse" of BBL and CBIL is particularly topical. Disqualifications for what are relatively small sums are making headlines
- As IPs we (and the OR) report on this conduct to IS/BEIS. We have seen most things from redundancy payments to family members to repayment of DLAs and the financing of other unconnected businesses

DLA, dividends and remuneration planning

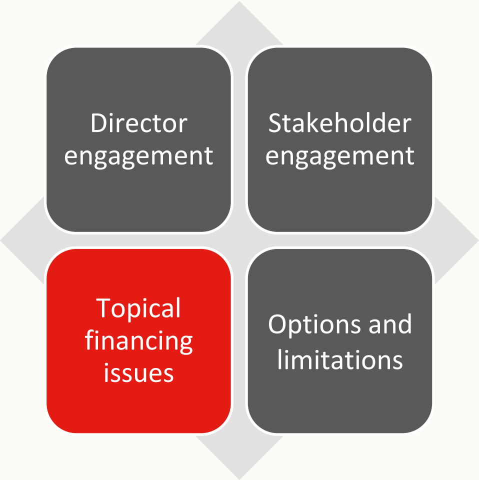
DLAs/dividends are often used in remuneration planning – depending on timing and the ability for the company to “pay” a dividend to clear the DLA, the directors can end up personally liable for something that, in their mind at least, is effectively remuneration. Beware unlawful dividends – need management accounts



- Almost all cases that we are involved in have a DLA in some form
- Some are in credit but the majority are owed to the Company
- The majority of those are caused by faulty remuneration planning – taking money out of a company without paying tax. Often directors do not understand it (and blame their accountants!)
- IP will seek recovery of the DLA in a formal insolvency. Often seen as unfair (by the director!) but they’ve had the money tax free…
- Don’t get caught with bad remuneration planning if insolvency threatens. Better to pay the tax than owe 100% via a DLA or unlawful dividends that can be clawed back

Personal Guarantees (PGs)

Are directors aware of the PGs that they have and the implication? Often director either are not aware or claim not to be aware of their PGs. Beware clients who are just getting deeper and deeper into trouble. Beware trying to improve personal position also!



- PGs are also very common as you would expect
- More prevalent now with the likes of Funding Circle, IWOKA, Nucleus and other similar lenders taking PGs and no corporate security. Take a very active role in CVLs. Secured lenders unaware!
- Attitudes vary considerably from:
  - Won't give one under any circumstances; to
  - "In for a penny, in for a pound"
- Watch out for "subtle" preference issues and clients that are just getting deeper and deeper

Options and limitations

Options and limitations

Limitations	Options
Too late	Negotiation
Fatigue	Refinance
Poor information	Formal
Board conflict	Do Nothing!

Limitations

- Advice and assistance sought too late
  - Limits the options available
  - Maybe too late to have meaningful engagement with stakeholders
  - Too late to implement change
- Director Fatigue
  - Can't see the light at the end of the tunnel
  - Little or no reward
  - But very often our involvement provides release

Limitations

- Poor financial and other information
  - Cannot evaluate options and actions required
  - Lack of credibility
  - Solution maybe third - party involvement but often resistant to cost
- Board conflict inhibits decision making and clarity
  - Essential that the Board acts as one
  - Debate and discussion is necessary but buy - in and consensus is vital

Options

- Negotiation and engagement
  - Potentially the most difficult to manage as there are no rules.
  - Get ahead of the game ie don't leave things too late
  - Stick to the plan but if things change re - negotiate
- Refinance and restructure
  - May be forced into this
  - There are likely to be a number of options
  - Cost. Risk. PG's and other security
  - Cost cutting. Efficiency improvement. Shed unprofitable operations.

Options

- Formal insolvency can't be discounted
  - Depends where we are on the distress curve
  - Not always the end of the road
  - Maybe optimum solution but inevitably stakeholders will suffer
  - Provides relief
- Do nothing and carry on
  - Position may not be as critical as first thought
    - Responsible directors taking early advice
  - Failure to recognise warning signs, advice ignored
    - Options likely taken out of board control improvement.

How long do you expect the UK will be in recession for?

ⓘ Start presenting to display the poll results on this slide.

Actions and Key Messages – Fit for Recession

- Good financial information together with a plan and strategy is essential
- Directors must take their responsibilities seriously of course but do not be fearful of them within a well managed business
- Recognise that there may be financial issues ahead and get ahead of the game with cost cutting and efficiency improvements

Actions and Key Messages – Fit for Recession

- Engage with all (relevant) stakeholders
- Evaluate and recognise what options you have and what likely outcomes are in different scenarios
- TAKE EARLY ADVICE!

Any Questions?

Thank you for listening