

Insolvency for incorporated associations and companies limited by guarantee

Legal information for community organisations

This fact sheet covers:

- ▶ what does it mean to be insolvent?
- ▶ the duty to prevent insolvency
- ▶ consequences of breaching the duty
- ▶ protecting against insolvency
- ▶ key warning signs of insolvency
- ▶ what to do if you think your organisation is insolvent or nearing insolvency, and
- ▶ finding insolvency experts

This fact sheet provides information for incorporated associations and companies limited by guarantee (CLGs) that are facing financial difficulties or are concerned about becoming insolvent.

Not-for-profit community organisations face financial difficulties for a number of reasons. Whatever the cause, these financial problems may lead to insolvency, and you should be aware of what it means to be insolvent and what action to take to protect your organisation from insolvency.



Disclaimer

This fact sheet provides information for incorporated associations and CLGs on insolvency. This information is intended as a guide only and is not legal advice. If you or your organisation has a specific legal issue, you should seek legal advice before deciding what to do.

Please refer to [the full disclaimer](#) that applies to this fact sheet.

What does it mean to be insolvent?

It's often difficult to determine whether an organisation is insolvent just by looking at its financial records and accounts.

An organisation experiencing an irregular shortage of cash is not necessarily insolvent. Similarly, if an organisation's assets exceed its liabilities, it's not necessarily solvent. **A range of factors are relevant**, and insolvency is determined by looking at the financial position of the organisation as a whole.

The test to decide whether an organisation is insolvent is whether it is 'unable to pay its debts as and when they become due and payable'.



Factors considered in determining whether an organisation is able to pay its debts when they become due and payable include an organisation's ability to collect money owed to it, raise funds and sell assets (for a reasonable market value in a timely manner).



Note

In Australia, the words 'bankrupt' and 'insolvent' are often used interchangeably and taken to mean the same thing. However, 'bankruptcy' is a legal procedure for people (not organisations) who are insolvent.



Caution

Financial problems or insolvency are serious matters. Acting on early warning signs is important. This fact sheet provides general information. If you think your organisation is insolvent, or may be nearing insolvency, you should seek immediate expert advice.



Case example

In the case of *Sandell v Porter (1966) 115 CLR 666*, the court found that the inability to pay a certain debt does not alone prove insolvency, but can demonstrate a 'temporal lack of liquidity.' If you can obtain funds to meet your debt when it falls due by other means, you may not be insolvent. Your ability to repay a debt is not limited to cash and includes other resources such as the sale or mortgage of any security you may have or a pledge of your assets.

The duty to prevent insolvent trading

Incorporated associations and CLGs rely on their officers' actions. For this reason, officeholders of incorporated associations and directors of CLGs owe a number of legal duties to their organisations. These include a duty to prevent the organisation trading while insolvent.

This duty is made up of two parts:

- a duty to prevent insolvency, and
- a duty to act diligently and properly if insolvency does occur

Incorporated associations

The legislation that regulates incorporated associations in each state and territory generally sets out the duties of 'officeholders' (including committee members) in these associations. Officeholders have the following four basic duties:

- a duty to act in good faith in the best interests of the association and for a proper purpose
- a duty to exercise reasonable care, skill and diligence in carrying out the role of a committee member (officeholder). This means officeholders must prevent insolvent trading by the association, which includes the duty not to incur a debt that will cause the association to become insolvent
- a duty not to take advantage of their position as an office bearer or information they have gained in the role for personal advantage, and
- a duty to manage conflicts of interest between personal interests and the interests of the association



Officeholders of incorporated associations that are registered charities with the Australian Charities and Not-for-profits Commission (ACNC) must also meet their duties under The *Australian Charities and Not-for-profits Commission Regulations 2022 (Cth)* (ACNC Regulations).



Note

Ignorance is no excuse. An officeholder must not turn a 'blind eye' to the incorporated association's financial status or leave understanding the incorporated association's finances to the treasure and other officeholders.

Companies limited by guarantee

The *Corporations Act 2001 (Cth)* (Corporations Act) regulates CLGs and sets out directors' duties. These duties are similar to the duties of incorporated associations' officeholders. Directors of CLGs that are registered charities with the ACNC must also meet their duties under the ACNC Regulations.



Note – registered charities

An organisation registered as charity with the ACNC must comply with the [ACNC Governance Standards](#), which are a set of minimum requirements for the governance of a charity.

[Governance Standard 5](#) sets out the duties that apply to [Responsible People](#) (officeholders and directors) in a charity. These duties are largely consistent with the duties of association officeholders and CLG directors. Duties that make up Governance Standard 5 include the duty not to allow the charity to operate while it's insolvent.

Under the ACNC Governance Standards, it's the responsibility of the charity, not the individual person, to take reasonable steps to ensure that the Responsible Person understands and fulfils their duties under Governance Standard 5.

For further information see the '[ACNC Governance Standards](#)' webpage and the '[Governance for Good](#)' guide on the ACNC website.



For more information about the legal duties of officeholders and directors, see our [Duties Guide](#).

Consequences of breaching the duty

Incorporated associations

The state or territory regulator may issue penalties to officeholders who breach their duties by allowing their organisation to operate while insolvent. The main types of legal action that can be taken against officeholders for insolvent trading include:

- compensation proceedings
- criminal charges, and
- civil penalties



The legislation governing incorporated associations in each state and territory provides monetary penalties of up to \$63,200 (this differs in each jurisdiction) for breaches of officeholders' duties, and in some cases, imprisonment of up to four years (this differs in each jurisdiction).

In cases of insolvent trading, officeholders may commit an offence by allowing the organisation to incur debts while insolvent. Officeholders may also then be personally liable (legally responsible) to pay any debts incurred by the organisation or to compensate for any loss which has been suffered.



Case example – an insolvent trading penalty

The legislation doesn't distinguish between active or inactive, executive or non-executive directors (or officeholders). If you are a director (or an officeholder of an incorporated association), you can be liable if you continue to trade while the organisation is insolvent and it is unlikely that the debt incurred will be repaid. The courts are strict in their judgment of insolvent trading.

In *Tourprint International Pty Ltd v Bott* [1999] NSWSC 571, a director in a small business joined the board of directors within one year of the company entering voluntary administration. Despite the short period that they were involved in the company, they were held liable to pay over \$500,000.

When facing personal liability for insolvent trading, officeholders may have defences available to them, such as:

- the debt was incurred without the officeholder's authority or consent
- at the time the debt was incurred the officeholder did not have reasonable grounds:
 - to believe that the association was insolvent, or
 - to expect that, if the association incurred the debt, it would become insolvent
- at the time the debt was incurred the officeholder had reasonable grounds to rely on the information provided by a competent person (for example an accountant or an actuary) about the solvency of the company
- illness, or
- the officeholder took all reasonable steps to prevent the debt from being incurred

The defences available to incorporated associations vary from state to state. It's important that you are familiar with the relevant rules in your jurisdiction.



Caution

Officeholders and directors should be careful not to rely on defences. Instead they should always take all reasonable steps to identify the cause of any financial difficulties the organisation is facing and take action to address them before it's too late.

Companies limited by guarantee

Significant civil (and in some cases, criminal) penalties can apply to directors of CLGs that breach their duties under the Corporations Act. Directors can be liable for civil penalty fines of up to \$200,000 and imprisonment for up to five years.

Directors can, in some cases, be required to compensate a company for breach of their duties. In addition, a court can disqualify directors from managing corporations for a period.



For general information on insolvency for directors whose companies are in financial difficulty, or are insolvent, and information on the most common forms of external administration see the [ASIC webpage 'Insolvency for directors'](#).



Note – registered charities

Under the ACNC Governance Standards, it's the charity's responsibility to take reasonable steps to ensure that the relevant people understand and fulfil their duties.

When a charity hasn't taken 'reasonable steps', the ACNC can take action including:

- warnings or directions from the ACNC Commissioner compelling compliance
- additional ongoing oversight and regulation by the ACNC through an enforceable undertaking (which if not complied with may result in court orders to cover losses suffered by the charity or to pay back any benefits gained as a result of the breach of the enforceable undertaking)
- suspension and prohibition of a relevant person from participating in governing the charity (which if breached could result in both civil and criminal penalties)
- apply administrative penalties, and
- deregistration of the charity

Where limits to the ACNC's legal powers mean it can't use all these options, it may refer the charity to other regulators (for example, the state regulator of an incorporated association) under agreements with them to promote a consistent approach to all registered charities.

People responsible for managing charities may also face civil or other penalties (for breach of those duties) under other legislation (such as state incorporation laws) and under the general law.

For further information, including what steps the charity can take to ensure the duties are understood and fulfilled, refer to ACNC [Governance Standards Guidance](#).



For more information about the legal duties of committee members and directors, including consequences for breaching these duties, see our [Duties Guide](#).

Protecting against insolvency

To help protect an organisation from insolvency, the officeholders of incorporated associations, directors of CLGs and 'responsible people' of registered charities, should always make sure they comply with their legal duties to:

- act honestly and diligently and in compliance with the organisation's rules or constitution
- act in the best interests of the organisation
- not use their position for personal advantage (or for the benefit of a friend or associate), and
- always disclose conflicts of interests

This means they must be careful and diligent in managing the financial situation of the organisation. In practice this means they should:



- keep up-to-date with the financial circumstances of the organisation at all times (ie. debts owed and cash flow)
- prevent the organisation from incurring debts when there are reasonable grounds to suspect it won't be able to repay them, and
- identify problems the organisation may have (including its expenses and liabilities, and income and cash flow) and put mechanisms in place to mitigate these problems

It's important that you get advice from an expert accountant or financial advisor at the first sign of trouble. Links to lists of financial advisors and institutions are below.



Tip

The best approach is to identify the cause of any financial difficulties well before they become a significant problem and seek professional insolvency advice

Key warning signs of insolvency

Warning signs of insolvency

The warning signs of insolvency may include:

- ongoing losses
- poor cashflow
- absence of a business plan
- incomplete financial records or disorganised internal accounting procedures
- lack of cashflow 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 organisation
- suppliers placing your organisation 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 or involvement by financier
- inability to raise funds from shareholders
- overdue taxes and superannuation liabilities
- board disputes and officeholder or director resignations, or loss of management personnel
- increased level of complaints or queries raised with suppliers, and
- an expectation that the 'next' big job, sale or contract will save the organisation

This is not an exhaustive list. There are a range of factors which may ultimately point to an organisation's inability to pay their debts when they fall due.



Caution

If creditors (including the ATO) threaten or start legal proceedings, **don't ignore them!**

The court may make an order placing your organisation into the hands of a liquidator in your absence. If you are aware of legal proceedings taken against your organisation, seek urgent legal advice.



Note – the meaning of some words used in relation to insolvency

Cash flow means cash received by the organisation minus cash paid over a given period of time; movement of cash in and out of an organisation over a given period of time.

Creditor means a person, company or other organisation that your organisation owes money to. For example, the organisation's paid staff are creditors if they are owed wages; the landlord may be a creditor if owed rent.

Debt means an amount owed by your organisation to a person, company or another organisation.

Debtor means a person, company or other organisation that owes your organisation money. For example, a person your organisation provided a service to in exchange for a fee, which has not been paid.

Administrator means people with specialist accounting training who are appointed to an organisation that is in or close to insolvency, to administer that organisation's affairs. Depending on the circumstances, the purpose of an appointment is usually to recover debts owed to creditors (to the extent possible) and, where there is no prospect of rescue, bring the organisation to an end.

Voluntary administration means the officeholders or directors have chosen to appoint a voluntary administrator (usually a qualified accountant or liquidator) to investigate the organisation's affairs and recommend whether the organisation should go into liquidation, enter a deed of company arrangement (in the case of a CLG) or return the organisation to the control of the officeholders or directors. This process often occurs when an organisation is, or is likely to become, insolvent.

Liquidation means an organisation will be wound up, and the sale proceeds will first be distributed among its creditors to repay any debts, with any remaining surplus going to the members. There are three types of liquidation: members' voluntary administration, creditors' voluntary administration and liquidation by court order.

What should you do if your organisation is facing insolvency?

If your organisation is experiencing any of the factors described above, take immediate action to prevent insolvency or to prevent the organisation from continuing to trade while insolvent.

Seek expert financial or legal advice. You should discuss your concerns with the organisation's accountant or auditor or another accountant who can help assess the financial position of the organisation. An advisor may propose actions that are most suited to your individual situation.

Examples of action you can take include:

- reduce expenses and liabilities (for example, review options for cost cutting, including reducing employee costs)



- increase income and cash flow by:
 - calling in any outstanding debts or fees owed to the organisation
 - seeking financial assistance from members
 - investigating alternative sources of income
 - approaching banks or other lenders for a loan (provided that the organisation will have sufficient income in the future to make repayments when they fall due), and
 - seeking financial assistance from the community, including through fundraising appeals
- negotiate a payment plan with the ATO if there are outstanding tax or superannuation guarantee contribution debts, and
- negotiate a payment plan with creditors including banks

If there is any doubt that any of these options will provide a quick turnaround, more drastic action may be required in the interests of the organisation, its members and its creditors.

An independent qualified accountant who has looked at the financial position of the organisation will be best placed to advise you on your options which may include appointing a liquidator or other external administrator. See the links below to find insolvency experts.



Tip

Acting early and getting expert advice can be the difference between your organisation surviving or not.

If your organisation is nearing insolvency, you should consider appointing a liquidator or administrator to manage its affairs. In some cases, this will result in the organisation being wound up.

If an organisation is insolvent or is nearing insolvency and has not acted to appoint an liquidator or administrator, an unpaid creditor of the organisation may start legal action to request a court to order that the organisation be wound up. When an organisation is wound up, it ends its operations and control of the company rests with the liquidator.

Voluntary administration

You may be able to place your organisation in voluntary administration.

Voluntary administration is the temporary administration of an organisation that is insolvent (or near insolvent) by an independent insolvency professional (an administrator). The administrator will assess whether the organisation can be restructured and continue, or should be liquidated.

Safe harbour provisions

CLGs can also take advantage of the 'safe harbour provisions' in section 588GA of the Corporations Act. These provide that a company's officer will be protected against a claim for insolvent trading if they can show that, after realising the company may become insolvent, the officer started developing a course of action that was reasonably likely to lead to a better outcome for the company. A 'better outcome' for the company means an outcome that is better for the company than the immediate appointment of an administrator or liquidator.

The period of safe harbour begins when the officer starts to suspect insolvency and starts developing a course of action likely to lead to a better outcome for a company.

The period of safe harbour ends at the earliest of the following:

- if the officer fails to take the course of action within a reasonable time – at the end of that reasonable period
- when the officer ceases to take any such course of action



- when that course of action ceases to be reasonably likely to lead to a better outcome for the company, or
- the appointment of an administrator or liquidator

Section 588GA of the Corporations Act sets out the factors that determine whether a course of action is reasonably likely to lead to a better outcome for the company. A key consideration in determining whether the course of action was reasonably likely to lead to a better outcome for the company is whether the officer sought the advice of a qualified person. **For this reason, it is critical that an officer gets expert insolvency advice.**



For more information about the options for an organisation that is insolvent or is nearing insolvency, see our [webpage 'Ending your organisation'](#).

Finding insolvency experts

Accountants

To find an expert accountant or financial advisor with insolvency experience, contact:

- [Australian Restructuring Insolvency & Turnaround Association](#)
- [Chartered Practising Accountants Australia](#)



Tip

When engaging an accountant or financial advisor:

- ask for a recommendation of a person or firm that has experience dealing with not-for-profit organisations
- ask for a guide to the fees they are likely to charge your organisation, and
- if your organisation is small or run by volunteers – ask if the accountant or auditor has reduced fee arrangements

Lawyers

- Law Institute of Victoria (LIV) – [Legal Referral Service](#)
- Law Society of NSW - [Solicitor Referral Service](#)
- Queensland Law Society - [Find a Solicitor](#)
- Law Society of Western Australia - [Find a Lawyer](#)
- Law Society of South Australia - [Legal Referral Service](#)
- Law Society Northern Territory - [Legal Referral Service](#)
- ACT Law Society - [Find a Lawyer](#)
- Law Society of Tasmania - [Search for a lawyer](#)



Tip

Most firms on the referral databases are private law firms – this means they charge normal solicitor fees. Be sure to ask about their fees before you meet with them for your first appointment



Caution

Choose your advisor carefully. There are many unqualified 'pre-insolvency' advisors who spruik their services online. It's not unusual for unprofessional advisors to contact directors who are in financial distress.

For these reasons, you may choose to engage an advisor accredited as a professional member with [Australian Restructuring Insolvency & Turnaround Association](#).