

Chris Johnson Associates Ltd.

Chartered Accountants & Insolvency Practitioners

PO Box 2499, Elizabethan Square, 80 Shedden Road, George Town, Grand Cayman, Cayman Islands
Tel: +345 946 0820 | Dir: +345 946 0830 | Fax: +345 946 0864 | Email: cdj@chrisjohnsonltd.com

Guide For Directors Of Insolvent Companies In The Cayman Islands

This guide provides general information on insolvency for directors whose companies are in financial difficulty, or are insolvent. Any queries related to this guide may be addressed to Chris Johnson Associates Ltd.

An Insolvent Company is one that is:

- When the company is unable to meet its debts as are when the company is unable to meet its debt as an when the fall down ('Cash Flow Insolvency').
- When the amount, of the companies liabilities (including its actual and contingent liabilities) exceeds the value its assets on a balance sheet basis ('Balance Sheet Insolvency').

Where a company is or about to become insolvent its directors must act in the best interest of the company's creditors (as opposed to the company's shareholders) and there are certain corporate and personal consequences for those creditors if they fail to do so.

If your company is in financial difficulty, you should seek independent advice on your duties and the options available.

Who is a Director?

A director is not just a person appointed to that role. A person may also be a director if they are not formally appointed but act in that role, or if the director of the company acts in accordance with their instructions or wishes.

What are the Duties of a Director?

Generally, in addition to the requirement to ensure compliance with general and specific laws applying to your company's operations. Your primary duty is to the shareholders. However, if your company is insolvent, or there is a real risk of insolvency, your duties expand to include creditors (including employees with outstanding entitlements).

General Duties



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General duties imposed on directors and officers of companies include:

- the duty to exercise your powers and duties with care and diligence that a reasonable person would have, which includes taking steps to ensure you are properly informed about the financial position of the company and ensuring the company doesn't trade while insolvent.
- The duty to exercise your powers and duties in good faith in the best interests of the company and for a proper purpose.
- The duty not to improperly use information obtained through your position to gain an advantage for yourself or someone else, or to cause detriment to the company.
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Duty to not Trade while Insolvent

As well as general directors' duties, you also have a positive duty to prevent your company trading while insolvent. This means that before you incur a new debt you must consider whether you have reasonable grounds to suspect that the company is insolvent or will become insolvent as a result of incurring the debt. An understanding of the financial position of your company only when you sign off on the yearly financial statements is insufficient. You need to be constantly aware of your company's financial position.

Duty-to keep Books and Records

In accordance with the Companies Law (2007 Revision) a company must keep adequate financial records to correctly record and explain transactions and the company's financial position and performance. A failure of a director to take all reasonable steps to ensure a company fulfils this requirement contravenes the Companies Law.

For the purposes of an insolvent trading action against a director, a company will generally be presumed to have been insolvent throughout a period where it can be shown to have failed to keep adequate financial records.



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Consequences of Insolvent Trading

Although there are no specific penalties under the Companies Law for insolvent trading, proceedings may be initiated by a liquidator against the directors in some circumstances.

What to do if you Suspect Financial Difficulty

If you suspect your company is in financial difficulty, get proper accounting and legal advice as early as possible, as this increases the likelihood of the company surviving. One of the most common reasons for the inability to save a company in financial distress is that professional advice was sought too late.

Do not have a 'head in the sand' attitude, hoping that things will improve--they rarely do. The table below lists some of the warning signs of insolvency.

An insolvency practitioner can conduct a solvency review of your company and outline available options. You need to be aware of your options so that you can make informed decisions about your company's future.

Options may include refinancing, restructuring or changing your company's activities, or appointing an external administrator. [^ top](#)

Signs that may Indicate your Company is at Risk of Insolvency:

- ongoing losses
- poor cash flow
- absence of a business plan
- incomplete financial records or disorganized 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



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- solicitors' letters, demands, summonses, judgments or warrants issued against your company
- suppliers placing your company on cash-on-delivery (COD) terms issuing post-dated cheques or dishonoring cheques
- 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

The Three most Common Forms of External Administration are:

- voluntary administration (which may lead to a deed of a company arrangement)
- liquidation
- receivership

Of these, only the first two are normally options for directors, as a receiver is usually appointed by a secured creditor.

What to do if your Company is Insolvent

If your company is insolvent, do not allow it to incur further debt. Unless it is possible to restructure, refinance or obtain equity funding to recapitalize the company, generally your option is to appoint a liquidator.

The purpose of liquidation of an insolvent company is to have an independent and suitably qualified person (the liquidator) take control of the company so that its affairs can be wound up in an orderly and fair way for the benefit of its creditors.



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An insolvency professional will be able to advise you of the steps required to appoint a liquidator. Generally, a director-initiated liquidation involves calling meetings of members and creditors to vote on winding up the company. [^ top](#)

Directors' Powers

Directors of companies in liquidation lose control of the company at the commencement of the winding up.

Directors' Obligations

Generally, directors have an obligation to assist the liquidator by:

- Advising the liquidator of the location of company property and delivering any such property in their possession to the external administrator.
- Providing the company's books and records to the liquidator.
- Advising the liquidator of the whereabouts of other company records.
- Providing a written report about the company's business, property and financial circumstances.
- Meeting with, or reporting to, the liquidator to help them with their enquiries, as reasonably required.
- Directors, officers and other people with relevant books and records have a responsibility to the company and to the creditors, and must not obstruct the liquidator in carrying out their duties.

Disqualification

Unlike many jurisdictions there are no provisions contained in the laws of the Cayman Islands for the disqualification of directors.

