EPISODE 2: INSOLVENCY AND TOUGH CONVERSATIONS TRANSCRIPT DOCUMENT

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AG: ALY GARRETT
KM: KAREN MCWILLIAMS
JF: JOHN FISK
AV: ANDREW VAN DER BEEK
PR: PETER RUPP
JS: JOHN SCHOL

AG: Hello, and welcome to the Acuity podcast. I'm your host, Aly Garrett, founder and principal of All In Advisory.

[00:19] Hasn't it been a whirlwind of a year? You could say it's been more like a tornado and we're not out of it yet. So what will the rest of the year bring? The new normal is like nothing we've ever experienced before. In Australia, two thirds of businesses have taken a hit to revenue or cash flow because of Covid-19. And almost one in three of those reported a decrease in revenue of 50% or more. In NZ, although some indicators are showing that economic activity is back at pre-pandemic levels, New Zealand business confidence has been shattered. So how can you give the best advice in such uncertain times? I'd like to welcome Karen McWilliams, business reform leader at CA ANZ.

Karen is responsible for shaping and influencing business reform for chartered accountants. Including insolvency, corporate governance, anti—money laundering, corporations law and sustainability matters. Karen, welcome to the podcast.

KM: Thanks, Aly.

[01:20] AG: Alongside Karen, is John Fisk. John is a partner at PwC NZ, He's also chair of RITANZ, the restructuring, insolvency and turnaround association of NZ and is here to share the learnings from his business journey and roles helping businesses that are struggling. Hello John.

JF: Hi Aly, thanks for having me.

AG: Karen and John are with me to chat about a very topical matter – when is the right time to wind up a business and how to take action. I guess for the many businesses that are struggling right now the question is, is it better to wind up the business now, rather than waiting until government subsidies end?

[1:59] KM: well Aly, I guess it depends on why the business is currently struggling and their ability to recover in the future. If the business is unlikely to recover when the government subsidies end, then it's clearly better to wind it up now. And it's important to remember it's not just the government subsidies that are keeping businesses going at the moment – but the ATO, banks, landlords etc not currently enforcing debts due to them in this environment. Now some businesses may be experiencing just temporary liquidity challenges as a result of the covid-19 pandemic, however for others particularly those who were perhaps doing it tough before covid hit, may now be in a position from which it's not possible to recover.

AG: So it really does look a lot deeper than those government subsidies and really goes back to the viability of that business pre-covid potentially.

[02:42] JF: I think it's exactly the same situation here in New Zealand and the thing that really concerns me is when you take an advantage of these subsidies and the forbearance that a number of stakeholders in the business have provided, the most important thing is actually using that time wisely to start planning for what you can do in the future and whether your business will be viable in the future and as Karen said if it doesn't look like it's viable then there's no reason to keep going - you should actually bring the business to an end.

AG: You know, what should businesses be focusing on now, moving past Covid, if they are not viable, what sort of things should they be doing now?

[03:30] JF: Well one of the things that I've noticed is that there are a lot of businesses that were perfectly successful pre-covid, that never had to worry about some of the disciplines of doing things like cash flow forecasting and so some of that really basic stuff, that you know insolvency practitioners take for granted that businesses would be looking at those sorts of things, a lot of businesses have just never been in that situation where they've needed to do that. And so one of the most fundamental things to do to actually determine whether you've got a viable business in the future is to do your cash flow forecasting and actually see whether you can actually survive and that's just really fundamental.

AG: As accountants we do need to understand the warning signs of when a business is in trouble. Can you highlight a few of those for us?

[04:23] KM: Certainly Aly. We recently spoke to some of our members working in insolvency and they have given us some early warning signs that businesses and I guess those that advise them should be watching out for. So these include things like the loss of a significant customer or supplier, a new competitor, forecast targets consistently being missed, missed payments to landlords, urgent request for bank funding, accounts payable days stretching over 45, overdue tax lodgements, and also looking if their business financials are not up to date or accurate. You know, a lot of businesses may not have been necessarily having to worry about some of these things so much pre-covid but obviously these are some of the even just general warning signs, I guess, that businesses need to be aware of.

AG: So what are the typical triggers that push a business into insolvency? How far does it have to go?

KM: When we look at registered liquidations in Australia report into ASIC on the top sort of nominated causes of failure for businesses, so in the last report the top three were inadequate cash flow or high cash use, poor strategic management of the business, and trading losses, and in New Zealand the insolvency and trustee services reported the top three primary causes were legal action, the failure to provide for tax and the inability to collect debts. So that gives you a broad, I guess, range of some of those triggers that actually tip the business over the edge.

[05:45] JF: If I can just add to that Karen, you can always tie all those things back to poor management and I always think when you see a business fail… it's a bit like watching a slow motion car crash. You know these things don't just happen overnight, they are things that have been evolving over a period of time and a business generally goes through cycles, so they can go through growth cycles and then cycles of decline and the key to survival for businesses is to be able to actually pick when you're starting to decline and pull out of the decline and go on to growth again. And it's actually something that the All Blacks do you know, to stay World champions – I just thought I'd add that in for the benefit of your Australian listeners (*all laugh*). Before they start to lose significance they are already planning what is the next new thing they need to be doing and in New Zealand we had examples recently of a men's clothing shop in Kawerau, which is a forestry area in New Zealand and it started its business back in the 60s as a suit shop – so you went in there to buy your suits. No one in Kawerau ever buys a suit anymore unless it's for a funeral. So they have reinvented themselves every few years with product that customers want and so many businesses that we see that fail, haven't had that ability to change. And when covid has come along, what's really happened is that you've had to put your foot on the accelerator incredibly hard to change really quickly because the change that's been imposed on you is so fast.

[7:38] AG: Karen, there's an assumption that small businesses are more likely to fail. What's the reality?

KM: Look I think the reality is there are more small businesses out there and probably they operate at much tighter margin so have less ability and less room for movement and to handle the varying sort of conditions. I mean when it comes to what small businesses can do, it is about getting this help early and actually talking to their accountant. And look we understand that for small business owners it's hard to make that call – advice might be just another cost that they've got to bear in these circumstances and it's just hard for them to admit that they need help until it's too late.

We did see a recent example of a small regional not-for-profit residential aged-care facility that was recently saved from insolvency as together its auditor they identified some early warning signs of solvency problems. By engaging the insolvency practitioner as soon as they spotted the early warning signs, the issues were quickly identified, the practitioner provided advice to the CEO that included things like facilitating talks with a range of stakeholders such as banks, competitors and the government, and gave them specific cash flow issues that they needed to monitor, all of that with the aim of then identifying a partner or transitioned ownership for an organization that could help them restore profitability. I guess together with the subsequently announced government support for aged care facilities, the facility was able to transform its business and avoid insolvency.

I think this success story just highlights the importance of that early recognition of looming insolvency – if you do it early enough then you're able to actually explore all of the options available which might include non-formal insolvency options such as a partner or transitional ownership. But also there was relevant targeted stakeholder identification, the timely government support and obviously a clear understanding of the solvency issues that were the cause.

[9:29] JF: You know one of the big problems we have in New Zealand and I imagine it's the same in Australia, is that a lot of small businesses are really grossly undercapitalized. They do not have a lot of resilience and we certainly saw that when covid hit...we were dealing with businesses – and sometimes quite large businesses – that got themselves into financial difficulty very quickly. And I think a lot of those businesses have survived in the last ten years or so because house prices have been going up all the time, and there's quite a bit of equity that they might have in that house - that house is usually the security that is provided to support any lending that's gone into the business so if it does get into trouble you know you end up selling the house and the debt is repaid. I am really concerned about what the future holds, particularly if house prices start going down, because that just makes those small businesses even more vulnerable than they have been to date.

[10:30] AG: You said that some businesses are undercapitalized – what sort of plans would you recommend they put in place to try to improve that?

JF: Unless you've got outside funding to go into capital, it's a really difficult question, but it is a very relevant one when you're looking at getting some of the government support that is available at the moment because, apart from the wage subsidies here in New Zealand a lot of the support is actually taking on debt, and the debt has to be repaid at some stage, so you know it becomes even more important to have an understanding of the viability of your business and your future cash flow to be able to work through - can you actually repay that debt. If you're getting a holiday from that revenue, if you are asking your landlord for a break for rent – often they're not writing off the rent, you're just pushing the problem down the road, if you're taking on a small business loan or the bank funding guarantee loan, you're going to have to pay it back. So that comes back to that viability issue. And then also, if you haven't got the right level of capital what are you prepared to give up? Because a lot of these small businesses aren't prepared to give up a 50% shareholding or greater amount of sharing the upside with someone else, but essentially you're going to have to if you need extra capital and you haven't got it from your own resources.

[12:02] AG: Most accountants would be aware of liquidation and may also have heard of voluntary administration, but may not understand what it is. Could you explain what a voluntary administration is?

JF: So look a voluntary administration is one of the formal processes that's available under the Companies Act in New Zealand and the intention of a voluntary administration is to rehabilitate the company, or if it can't be rehabilitated, get a better outcome than you would if you just went straight into liquidation. So, if you've got a business that just needs some breathing space to put a plan together and present what is called a deed of company arrangement or a docker, that's what voluntary administration is all about. It's not used in New Zealand nearly as much as what it's used in Australia though, and part of the reason for that is that it's quite expensive and there's other options that are available in New Zealand that I think actually can be more flexible and allow more options to be addressed. But again it comes back to the earlier you address these things, the more chances you've got of survival. So voluntary administration, yeah, it's really good. We've done some where it's worked really well and because it's an immediate moratorium on creditors taking any action, it can be very helpful for example when you've got a retail chain that has a lot of landlords that might cancel your lease if you go into… say receivership instead. But in New Zealand, I think what we're seeing is probably an increase in considering things like compromise which is more driven by the company and leaves the directors in control, with a bit of oversight from an insolvency practitioner for example. And, they are far less costly to implement and they don't have the same sort of social stigma that a VA has because VA you still have to put after the company name that it's in voluntary administration.

[14:12] AG: There are some really difficult conversations that accountants need to have with their clients regarding restructuring and insolvency. What's the best way of approaching these conversations?

KM: I think it's important for our members to remember that businesses fail for varying reasons, it's not because it's necessarily something that anyone has done wrong. I know sometimes for our members there can be a challenge in terms of having those conversations with clients because there's a feeling that if their client is failing then that's somehow a reflection on them as well and that's not necessarily the case and I think it's very important to have these tough conversations – and to have them early because the longer these things wait, then the more difficult that conversation will become. We're in exceptional times at the moment and so you know, I think that's when it gives us that sort of ability to open up those conversations with the clients, and give them the circumstances and really talk through with them what those options are for them.

JF: They are really difficult conversations to have and some people don't like to address it. But the important thing is to have empathy for your client and acknowledge the emotional part of this as well because there's a whole range of emotions that people go through when they're getting into financial difficulty. And until you've addressed those issues I think it becomes very difficult to address the cold hard logical commercial decisions that have to be made and you actually need to revisit those things over time as well. So acknowledging that this is a difficult conversation, spending the time with the right information to be able to demonstrate what you've done and where the business is and then working through a plan. I mean the most important thing I think for businesses is to have a plan and it provides focus for working out a way forward because you know it can be a very lonely existence for a director that's running a company that is getting into financial difficulty. There can be shame, lies can be told, often there's other things going on in their lives at the same time as well, so it's not unusual for us to deal with a marriage break up and things like that whilst a business is failing. So you can't just treat the insolvency of the business in a compartment and not acknowledge those other factors.

[16:46] Some of the accountants I've seen want to give the answers they think their clients want to hear, and you know this is a time when you're dealing with something like a business failure, you can't afford to do that and this is where being a true professional is really important. You've got a professional obligation to address those difficult issues and give clear advice about what steps should be taken rather than trying to be agreeable to what the client might be responding to.

[17:18] AG: Can you tell me about what it was like working at Pyke River Coal? What a difficult time that must have been and challenging for a CA?

JF: Yeh it sure was, and when you're studying to be a CA you never expect to be thrown into that sort of environment and it was a tragedy in New Zealand, one of the worst workplace accidents that we've ever had in our history and 29 miners died through four explosions that happened down there and we were appointed about three weeks after that all happened – you know the mine was still out of control, it was still burning, and one of the first jobs I had to do was talk to the families of the 29 men and let them know what had happened, in terms of the receivership. The thing that was incredibly challenging about that was that you're dealing with families and workmates that have lost people, at the same time you're trying to actually run a receivership and you can't do those sorts of things without having a really good team around you to support you and you can't do it without acknowledging that the first thing to deal with is actually the grief that is being felt in that community and so we were thrown into a bit of cauldron really of media interest, political interest, creditors that had lost a lot of money and a mine that was burning and you know we weren't sure whether it was ever going to get under control. And so, dealing with that and trying to get some recovery for creditors was a very challenging assignment.

[19:10] AG: I can hear how hard it is for you talking about it now.

JF: You've always got to address these things as a professional, but again acknowledge the difficulty that everyone was in. I look back at some of these stories we've had, it really comes down to that ability of management to recognise the situation early, to have a plan of how they're going to deal with it, to be willing to talk to their stakeholders about what their issues are early and not hide it from them so that they can get support for the plan that they've got and then the most fundamental of all is actually people with the motivation and energy to actually execute on the plan. And if you've got those four factors, then you've got the best chance of survival, in my mind. And if you haven't, then it's a case of being honest about not continuing, not to keep gambling on creditors money and go through a formal process and that's going to stand you in best stead to get the best recovery possible as well.

[20:39] AG: John Fisk and Karen McWilliams, thank you both so much for your time.

KM: Thanks Aly.

JF: Pleasure, thank you.

AG: The Chartered Accountants Australia New Zealand Forensic Accounting conference is running this November and will be fully online for the first time. Register now through the CA education store.

Right now though, here's our Acuity podcast hack guru Andrew Van Der Beek, director of Illuminate.

AV: Top transformational tech tool tips and tricks. Gee, that is a mouthful. Hey so what I want to get into is a few pieces of technology that I think are incredible in terms of bringing more efficiency, more automation, better client experience, inside your business. Now before I get started on these three tips, just a quick one, I am assuming you have one foot in the cloud technology space already. Because these tools are going to require a level of understanding on cloud technology. Number two, I am not paid by anybody that I'm recommending here, this is purely based on my experience, what I use and what I think is great.

So let's go into tip number one.
[21:46] Have you ever found yourself assessing software and you've got two options - option number one is you get the all in one solution and it does pretty much everything you need, but it's not as efficient or it's not as appealing on the eye for your clients. But when you look at the alternatives out there, it's a bunch of best in class software but they don't necessarily integrate directly so when you do something in one place you want that information to go to another piece of technology so you're not having to double handle it. Well there's this great piece of tech out there called Zapya - or Zapya. ~~Effectively what it does~~ it works as the middleman - it sits in between two pieces of technology and if you do something in

one place, it will take that information, that data and will put it into the other piece of tech. That could be things like, if someone enquires something on your website, it can help trigger a bunch of actions and activities and put information in places. It could be something around workflow - if you're getting to a stage in your workflow and you want to trigger a bunch of different things in different pieces of your tech, you could use Zapya to do that for you as well. We love it and we think it's fantastic. [22:47] Alright, tech tip number two. And this is around workflow, automation, client experience, and what not. There is a great piece of tech that's come out of South Australia, it's still relatively new, called FYI Docs. We've been using it for a little while here at Illuminate and we're really seeing an increase in automation and efficiency with our team as well as visibility on what's going on in the world of our clients. And I think it's going to be a really cool piece of tech for accounting businesses. Some things to be aware of - it does require you to be on the Microsoft platform, so it sits inside of there, it pulls data out of your emails, it allows you to save documents to clients, to jobs, but bringing automation inside of that too, that's the key, is the automation side of things, it's not just a document management piece of software.

Now the third one is all around client experience and all around communication. Because there's nothing worse than constantly getting people asking you to call them up about tiny little things that you know is a waste of your time. Why would I call someone to speak to them for half an hour over something that really takes 30 seconds to solve. Loom - it is a web browser or desktop based software and what it does effectively it will use your webcam to record you. But it will also record your screen at the same time if you want it to. So you can see the value in here is, hey I'm just inside my Xero file and I'm trying to understand how to do something. You can quickly record a 30 second Loom of you talking to them whilst you do it, so they learn how to do it next time. Or it could be, hey client, I've just gone over your financials and I want to walk you through the end result. Or it could be, hey prospective client, here is our proposal. You're going to walk through and look at it and I want to make sure I'm communicating as best as I can to help you understand it. Highly recommend - I think it's incredible.

Those are my three top transformational tech tool tips and tricks, peace out!

[24:44] AG: And now it's time for conversations with Gen CA, here's Peter Rupp, President of CA ANZ speaking with John Schol.

PR: I'm here with John Schol. He's made the radical transformation from painter's apprentice to accounting student after being inspired by the way a local accountant supported businesses to create opportunities from challenging times. Twenty years later, he's now offering that same service to his peers in the accountancy field, looking for innovative ways to reinvent business models for our sector and our clients. John, welcome to the program.

JS: Thanks Peter, it's great to be here.

PR: So let's take us back to that first experience working for an accountant, I understand you spent quite a bit of time up that ladder.

JS: Yeh look I had an interesting introduction to accountancy. When I was leaving school I wasn't sure whether I wanted to be a school teacher, accountant or a painter. And I had a mate who was a painter and I took the path of least resistance I suppose and I started working for him and it was around end of November, start of December and he just got his accounts done, as many small businesses do and he had, what I now know is a double tax year - so he'd made quite a lot of money and had a lot of tax to pay and had already spent the money and his accountant helped him out a lot and he was just really grateful and thankful, and talked about him in a really positive way over the first few weeks I was talking to Mark. And then we funnily enough went to paint this accountants house and so we rocked up to the house and I'm standing on top of this two-storey character home looking down at this person's life, thinking wow, he's really rated highly and he seems to have a pretty good life and I probably thought looking down on a white picket fence that I could slip off the roof at any time and perhaps impale myself on and thought, maybe a change of career needs to happen now so my first career lasted about a fortnight before I decide I'd hit done and applied at the local SIT to begin my accounting degree.

[26:52] PR: So you must've been on quite a journey in those 20 years. I know technology is a big part of what you do in your business. What are some of the bigger changes you've seen over that time?

JS: I think traditionally, clients have come to us at the tail end and asked for advice, and slowly with technology we've worked backwards to create information and now we're able to mine the data. I see our world as accountants, not so much changing, but just enhancing and focusing on the areas where we're able to add more value, now we've got permission to try new technology - I wasn't a great user of Zoom before this, but now I'm quite the expert. I've delivered a number of webinars now, I'm using the white board on Zoom, I'm sharing, I'm doing find discovering things all the time, it's just creating new opportunities for us to think differently about how we interact. And the level of formality that we have to have with some of our clients as well, I think that's changed because of the situation we're in. Now we've got the ability to say, well in my experience we need to get this this and this in, and it's not a product push, it's actually helping people within their business with the services we've got.

PR: So aside from the way you're working though, are there other innovations and adaptations you've had to make which you think could become a permanent reality?

JS: Ability for them to - and for us - to converse on a more informal basis. When you get yourself into a situation like Covid-19, everyone's backs against the wall and it's about getting them together. The one thing I don't want to see in my office is for us to revert back to the way we were. That would be such a waste of a magnificent opportunity we've got to make a step change in the way we think about and how we serve our clients, but also how we serve ourselves and how we serve each other. And the use of teams and our daily huddles - they don't have to be in person, we can sit here like we are today and we can converse quite well without actually needing to be in the room. It's about looking beyond the numbers, it's about having empathy, it's about communicating, it's being able to sell our services to our clients. So we don't want to be audit takers where they come to get their tax return done every year and maybe a cash flow that they put in their bottom drawer, you know. We want to be active participants in our clients' businesses and so what Covid-19 has allowed us to do is push that barrier a little bit further and to get more mobile and to put our headset on and to be proactive with our clients and to create webinars and to create opportunities where they can ask us questions.

PR: So as a chartered accountant, what does the CA designation mean for you? And also with our younger students coming through, what advice would you give them about starting their career in the accounting profession?

JS: Look, I think being a member of CA ANZ just opens up doors, first and foremost for your career. I've been lucky enough to travel overseas and get really good jobs because of the CA designation, but we are really difference makers - we're here to help, positively affect people's lives and we can help people formulate what success looks like. And that's helping create those goals, those milestones and those actions and just to mark progress for people. Because people do see chartered accountants as a trusted advisor and we are a big conduit for knowledge. You don't just get your degree or do your professional exams and then you're done, this is a lifelong learning journey that we're on, you should never be a product of your environment, you should always be the creator of your environment and you've got to be proactive when you do that. That would be my message to people, is just to keep embracing change and always ask where's the opportunity in any situation.

PR: Great thanks very much John.

JS: Thanks very much Peter, great to be here, great to chat today. Thank you.

AG: Thanks for listening to this episode of the Acuity podcast. I'm Aly Garrett from All In Advisory.

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See you next time!

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