Advanced Training of Judges in Aspects of Bankruptcy and Reorganization

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MAKING DECISIONS

- INCOME STATEMENT – summary display of proceeds earned and expenses incurred during regular operations in certain time period
- BALANCE SHEET – displays financial position of some business entity on certain data, and gives overview of operations in terms of resource and sources management (sources consist of company’s liabilities and equity)
- CASH FLOW – shows cash generated in regular business activities, as well as important investment and financial transactions that take place during one accounting period

MAKING DECISIONS

- THE GOAL OF FINANCIAL STATEMENTS IF MAKING BUSINESS DECISIONS:

1. Maintaining satisfactory solvency
2. Achieving satisfactory profitability

REASONS FOR BANKRUPTCY

- INSOLVENCY (30 or 60 days)
- THREATENING INSOLVENCY (in this case only bankruptcy debtor can file the motion for initiation of bankruptcy proceedings)

REASONS FOR BANKRUPTCY

WHAT IS INSOLVENCY OF DEBTOR?

- Unable to make payments on due liabilities;
- Partial and individual repayment of creditors;
- 30 or 60 days in a row, fails to repay due monetary liabilities.

ASSESSMENT OF SOLVENCY

Solvency means possessing sufficient available money to pay due debts and cover unexpected cash requirements.

Two measures of solvency are WORKING CAPITAL and CURRENT RATIO.

ASSESSMENT OF SOLVENCY

A company will face the insolvency problem in the following situations:

1. Attaching funds to non-current assets (for example space arrangement)
2. Inappropriate financing of a business operation (for example financial liabilities not adjusted to cash income)
3. Production expenses higher than cash income
4. Financial liabilities grow faster than cash generating capability (for example too fast growth of a company)

ASSESSMENT OF SOLVENCY

WORKING CAPITAL is the amount by which total current assets exceed total current liabilities.

- Current liabilities are paid from current assets;
- Surplus of current assets, compared to current liabilities, are assets at company's disposal for continuation of business (maintaining operative cycle);
- Lack of working capital can ruin a company!!!

ASSESSMENT OF SOLVENCY

Example:

Current assets (cash+receivables+inventory) 125,000 KM

Minus

Current liabilities (bank, payables, salaries) 45,000 KM

= WORKING CAPITAL 80.000 KM

ASSESSMENT OF SOLVENCY

CURRENT RATIO is another indicator of liquidity, and it represents the ratio between current assets and current liabilities.

(many bankers and lenders consider it the right indicator of a company's ability to pay due payables, and to make regular payments on existing loans)

- Average current ratio varies significantly depending on type of business activity;
- Significantly LOW or HIGH current ratio may be highly unfavorable (very high current ratio might mean that a company does not utilize its assets efficiently)

ASSESSMENT OF SOLVENCY

Example:

Current ratio = Current assets/Current liabilities

Current ratio = 125,000/45,000=2.78

Interpretation of the ratio: for each mark of debt the company has 2.78 KM of current assets available

ASSESSMENT OF SOLVENCY

QUICK RATIO is also the measure of solvency, but it includes only the MOST LIQUID assets, i.e. assets that can be easily turned into cash in order for a company to repay debts.

“Quick”=(cash+HOV+receivables)/Current liabilities

Interpretation: is this ratio is less than 1, that means that a company depends on sale of inventory.

PRACTICAL EXAMPLE