



ASIC
Australian Securities &
Investments Commission

REGULATORY GUIDE 22

Directors' solvency declaration

March 2023

About this guide

This guide is for directors and auditors, and their advisers. The objectives of this guide are to:

- explain the requirements for the directors' solvency declaration under s295(4)(c) and s303(4)(c) of the Corporations Act;
- outline the obligations of directors when making the declaration on the solvency of an entity; and
- outline the obligations of the auditor in relation to the directors' solvency declaration.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This guide was issued in March 2023 and is based on legislation and regulations as at the date of issue.

Previous versions:

- Superseded Practice Note 22, issued 15 June 1992, rebadged as a regulatory guide 5 July 2007

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act applies to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

A	The solvency declaration	4
B	Directors' obligations	5
	Debts to be taken into account	5
	Matters to be considered by directors	6
	Qualified and negative solvency declarations	7
C	Auditor's obligations	9
	Key terms	11
	Related information	12

A The solvency declaration

Key points

This section explains that:

- the directors' declaration is part of the financial report and includes the solvency declaration;
- the solvency declaration is required for companies, registered schemes and sub-funds of corporate collective investment vehicles (CCIVs); and
- for registered schemes, the directors of a responsible entity are treated as the directors of the registered scheme and the directors of the corporate director of a CCIV are treated as directors of each sub-fund of the CCIV.

RG 22.1 The directors' declaration is part of the financial report under Ch 2M of the *Corporations Act 2001* (Corporations Act): s295(1). The directors' declaration includes a solvency declaration which is a declaration by the directors 'whether, in the directors' opinion, there are reasonable grounds to believe that the company, registered scheme or disclosing entity will be able to pay its debts as and when they become due and payable': s295(4)(c). The directors of the responsible entity must make the declaration for a registered scheme: s285(3)(b).

Note: In this guide, references to sections (s), chapters (Ch), divisions (Div) and parts (Pt) are to the Corporations Act, unless otherwise specified.

RG 22.2 A solvency declaration is also required in the directors' declaration for each sub-fund of a retail corporate collective investment vehicle (CCIV): s1232C(2)(b). The directors of the corporate director must make the declaration: s1232C(4)(b). The debts are only those referable to the sub-fund: s1232D(1).

RG 22.3 In this regulatory guide, 'entity' refers to a company, registered scheme, disclosing entity or sub-fund of a CCIV.

RG 22.4 The half-year financial report of a disclosing entity must also include a directors' declaration containing a solvency declaration: s303(1) and s303(4)(c). The guidance in this regulatory guide for the annual solvency declaration also applies to the half-year solvency declaration.

B Directors' obligations

Key points

This section explains the obligations of directors in making the solvency declaration, including:

- which debts to take into account in assessing solvency;
- matters to be considered by the directors in making the solvency declaration; and
- when directors can give a qualified solvency declaration and when they should give a negative solvency declaration.

Debts to be taken into account

- RG 22.5 When forming their opinion on the solvency of the entity, the directors must consider the entity's capacity to pay debts it has incurred as at that date, rather than as at the end of the financial year.
- RG 22.6 The Corporations Act does not directly specify whether, or to what extent, directors should take into account debts which will be incurred in the foreseeable future. We consider that the words, 'will be able to pay its debts as and when they become due and payable' (s295(4)(c)) introduce a prospective element into the declaration. Accordingly, in forming their opinion, the directors should consider future debts to the extent that they will compete for payment with the debts existing at the date of the declaration. The prospective period to be considered by the directors is not limited to the date of the subsequent directors' declaration, but the period up to that subsequent declaration will be of significance to the directors' opinion.
- RG 22.7 Whether the directors have reasonable grounds for their opinion should be decided on the basis of an objective test as stated by Mahoney JA in *Dunn v Shapowloff* [1978] 2 NSWLR 235 at 238; (1978) 3 ACLR 775 at 783. It has also been held that 'unquenchable optimism' is not a reasonable ground of belief: see *CCA v Daff* (1971-76) ACLC 28, 756. Directors should also be aware of the sanctions for false or misleading statements (s1308) and false information (s1309).
- RG 22.8 While the solvency declaration is made at a point in time, the duty of directors to prevent insolvent trading under s588G of the Corporations Act applies on an ongoing basis. Directors should therefore review solvency as frequently as the entity's circumstances require.

Matters to be considered by directors

- RG 22.9 Directors must have reasonable grounds for believing that the entity will be able to pay its debts as and when they fall due. In meeting the reasonable grounds requirement, directors should consider a wide range of information such as:
- (a) cash balances or overdrafts, the amount and timing of operating cash inflows, access to credit lines and undrawn facilities, and the liquidity of non-core investments;
 - (b) the timing and amount of payment obligations, supplier credit terms, debt repayment dates, and the end date for any loan repayment or rent holidays;
 - (c) the ability of customers and borrowers (including related parties) to meet their obligations to the entity, including meeting credit and repayment terms;
 - (d) known or likely changes in economic and market conditions, consumer behaviours and demand, inventory turnover, supply chains, production processes, and the ability to deliver goods and services;
 - (e) the ability of the entity to comply with debt covenants and normal terms of credit, renegotiate debt arrangements, and refinance maturing debt;
 - (f) the possibility of withdrawal of financial support by major lenders;
 - (g) the possibility of debt factoring arrangements, customer supply chain financing or financial support by a parent entity not continuing;
 - (h) the ability and willingness of a parent or shareholders/owners of the entity to meet any financial support arrangements;
 - (i) the solvency of any entities to which the entity has given financial guarantees or offers of financial support; and
 - (j) any uncertainties affecting the above.
- RG 22.10 In addition to recording the resolution required by s295(5) or s303(5), it is desirable that the minutes record the basis on which the resolution was made.
- RG 22.11 When forming their opinion on the solvency of the entity, the directors must consider the entity's capacity to pay debts which it has incurred as at that date, rather than as at the end of the financial year.
- RG 22.12 Directors should appropriately question the information they consider about the entity's solvency, the reasonableness of any key underlying assumptions, and the reliability of processes used to produce the information. Directors should ensure that the information is consistent with their understanding of the business, the markets in which the entity operates and any other relevant matters.

Qualified and negative solvency declarations

- RG 22.13 Depending on the circumstances of each entity, the solvency declaration may state that:
- (a) the directors have reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable;
 - (b) there is a material uncertainty as to whether the company will be able to pay its debts as and when they become due and payable; or
 - (c) the directors do not have reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.
- RG 22.14 The obligation of the directors under s295(4)(c) is to form an opinion whether there are reasonable grounds to believe that the entity will be able to pay its debts as and when they become due and payable. The solvency declaration may be qualified if there are material uncertainties—for example, there may be uncertainty as to whether the entity is able to renegotiate borrowings due for repayment. However, directors should not qualify their solvency declaration when the circumstances do not warrant it. A qualified statement will not of itself operate to limit the liability of the directors, nor operate as a substitute for the proper discharge of their responsibilities.
- RG 22.15 Situations may arise when doubt over whether the entity can pay its debts as and when they become due and payable is such that it is not appropriate for directors to sign the directors' declaration with a qualification. In these situations, the directors should make a negative statement stating that the entity is unable to pay its debts as and when they become due and payable.
- RG 22.16 It is not possible to state in precise terms when a qualification is no longer appropriate. Nevertheless, a qualification should not be an expression of hope or envisage an unlikely scenario. Commonly, the factor determining whether an entity is solvent will be the existence of financial support from a bank or shareholder. For a qualified directors' declaration to be appropriate, negotiations should at least be underway with a reasonable likelihood of placing the entity in a position where it is able to pay its debts as and when they become due and payable.
- RG 22.17 A qualified or negative statement must be clearly worded and in sufficient detail for the reader to comprehend the statement fully. The statement should identify the item which is the subject of qualification and disclose monetary details where practicable. Where a qualified declaration impinges on the 'going concern' assumption as the basis for preparing financial statements, the directors should explain in the financial report their reasons for adopting the assumption in light of the qualified declaration.

- RG 22.18 Similarly, where directors state that there are reasonable grounds to believe the entity will be able to pay its debts as and when they become due and payable despite prima facie indications to the contrary from the financial report, the directors should disclose the reasons for that opinion in order to ensure that the financial report gives a true and fair view.
- RG 22.19 Irrespective of whether the solvency declaration is positive, negative or qualified, a director contravenes the Corporations Act if they fail to prevent a company from incurring a debt when, at the time, there are reasonable grounds for suspecting that the company is insolvent or will become insolvent by incurring the debt: s588G.

C Auditor's obligations

Key points

This section outlines the auditor's obligations in relation to the solvency declaration, including:

- determining whether there is a defect or irregularity in the solvency declaration; and
- reporting suspected contraventions of the insolvent trading provisions of the Corporations Act to ASIC.

- RG 22.20 The solvency declaration is part of the financial report. The auditor must form an opinion about whether the report complies with the requirements of the Corporations Act. Auditing standards require the auditor to obtain reasonable assurance as to whether the financial report as a whole is free from material misstatement. Whether the entity is solvent could be expected to be material in nature.
- RG 22.21 In this context, the auditor should perform relevant audit work on whether the entity will be able to meet its debts as and when they fall due. The auditor plans the nature, timing and extent of audit work based on their understanding of the business and their assessment of risk, and reassesses the planned audit work taking into account relevant matters identified during the audit. The auditor considers possible indicators of solvency risks, considers information such as that outlined in this regulatory guide, and performs appropriate audit work on the reliability of the information. In performing their work, the auditor should apply appropriate professional scepticism.
- RG 22.22 For financial reporting purposes, solvency is assessed at the time of the directors' declaration and auditor's report. Audit work otherwise performed on the income statement, balance sheet and subsequent events may not be sufficient to cover solvency. Audit work on cash flows in a discounted cash flow model for asset impairment testing may not be sufficient for solvency purposes because, for example, the impairment model is unlikely to include all cash flows of the entity and the timing of cash flows in an impairment model may not be sufficiently precise.
- RG 22.23 The auditor has an obligation under s308(3)(a) to describe in the auditor's report any defect or irregularity in the financial report. The auditor is therefore obliged to consider the solvency declaration and to provide such a description where there is reason to believe that a defect or irregularity exists. Auditing standards may also require a modified opinion or disclaimer of opinion in the auditor's report. The auditor should also consider the need to include a key audit matter in the audit report for a listed entity.

RG 22.24 An auditor of an entity who at any time of the year suspects that the insolvent trading provisions of the Corporations Act have been contravened should report the matter to ASIC as required by s311: see [Regulatory Guide 34](#) *Auditor's obligations: Reporting to ASIC*.

Key terms

Term	Meaning in this document
CCIV	<p>A corporate collective investment vehicle—a company that is registered as a corporate collective investment vehicle under the Corporations Act</p> <p>Note: This is a definition contained in s9 of the Corporations Act.</p>
corporate director	<p>The company named in ASIC's record of the CCIV's registration as the corporate director or temporary corporate director of the CCIV</p> <p>Note: This is a definition contained in s1224(3) of the Corporations Act.</p>
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
disclosing entity	Has the meaning given in s111AC of the Corporations Act
entity	A company, registered scheme, disclosing entity or CCIV
registered scheme	A managed investment scheme that is registered under s601EB of the Corporations Act
responsible entity	A responsible entity of a registered scheme as defined in s9 of the Corporations Act
s295 (for example)	A section of the <i>Corporations Act 2001</i> (in this example numbered 295)
solvency declaration	Declaration by the directors of an entity under s295(4)(c) or s303(4)(c) of the Corporations Act as to whether, in their opinion, there are reasonable grounds to believe that the company, registered scheme or disclosing entity will be able to pay its debts as and when they become due and payable
sub-fund (CCIVs)	<p>Has the meaning given in s1222Q of the Corporations Act</p> <p>Note: A sub-fund is established on the day on which it is registered: see s1222T.</p>

Related information

Headnotes

auditor's report, directors' declaration, financial report, insolvent trading, solvency

Regulatory guides

[Regulatory Guide 34](#) *Auditor's obligations: Reporting to ASIC*

Legislation

Corporations Act 2001, s285(3)(b), 295(1), 295(4)(c), 295(5), 303(1), s303(4)(c), 303(5), 308(3)(a), 311, 588G, 1232C(2)(b), 1232C(4)(b), 1232D(1), 1308, 1309

Cases

CCA v Daff (1971–76) ACLC 28, 756

Dunn v Shapowloff [1978] 2 NSWLR 235; (1978) 3 ACLR 775