KPMG

News - 2022/01

Accounting Advisory / KPMG in Slovakia
May 2022

Company in Crisis, Act on Solving an Impending Insolvency

The National Council of the Slovak Republic has approved Act No. 111/2022 Coll. of 16 March 2022 on Solving an Impending Insolvency and on Amendments to Certain Laws ("Act on Solving an Impending Insolvency"). Some other existing laws have also been amended, for example, Act No. 7/2005 Coll. on Bankruptcy and Restructuring, the Commercial Code, and others. Certain provisions will **enter into force** on 1 May 2022, and others on 17 July 2022.

This Act transposes Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) into the laws of the Slovak Republic.

A) Situation BEFORE the adoption of the Act on Solving an Impending Insolvency

Insolvency. Even before the Act on Solving an Impending Insolvency was approved, we, in our capacity as auditors, had to pay attention to whether or not a company was **insolvent** (Article 3 (1) of the Act on Bankruptcy and Restructuring) – in order to assess, in particular, a company's ability to continue as a going concern, i.e., whether or not it was:

- **over-indebted** or
- **unable to pay its debts as they fell due** (insolvent).

Company in crisis. We also had to pay attention to whether or not a company was in crisis. The term **"company in crisis"** was incorporated into the Commercial Code (Article 67a of the Commercial Code) in 2015; this amendment to the Commercial Code was also referred to as "Lex Váhostav." A company is in crisis if it is:

- insolvent or
- at risk of becoming insolvent.

The definition of the term **"insolvency,"** as referred to in Article 3 of the Act on Bankruptcy and Restructuring, has not been changed – a company is insolvent if it is over-indebted or unable to pay its debts as they fall due (insolvent). The term **"at risk of becoming insolvent"** was new. A company is at risk of becoming insolvent if its equity to liabilities ratio is less than 8 to 100. Regarding the calculation of this ratio, see also NEWS 2021/03 (the Act on Accounting was amended in November 2021, and according to Article 28 (6), accrual/deferral accounts of expenses and income on the liability side of the balance sheet are not included in liabilities for the purpose of assessing whether a company is in crisis).

The **prohibition of paying back considerations substituting for own resources** is important with regard to a company in crisis. A consideration substituting for own resources, together with accessories and a contractual penalty, cannot be paid back if the company is in crisis or were to find itself in crisis as a consequence thereof (Article 67f of the Commercial Code).

KPMG
© 2022 KPMG Slovensko spol. s r.o., a Slovak limited liability company and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

B) Situation AFTER the adoption of the Act on Solving an Impending Insolvency

Company in crisis. It continues to apply that a company is in crisis if it is:
- insolvent or
- at risk of becoming insolvent.

Based on the amendment, the words "A company is at risk of becoming insolvent" in Article 67a (2) of the Commercial Code have been replaced by the words "A company is also in crisis if", and the amended wording of this paragraph is as follows: ~~A company is at risk of becoming insolvent~~ **A company is also in crisis** if its equity to liabilities ratio is less than 8 to 100.

The change has been that a situation where the equity to liabilities ratio is less than 8 to 100 continues to be considered a situation where a company is in crisis (with all the attendant consequences, including, for example, the prohibition of paying back considerations substituting for own resources), but it is no longer referred to as "being at risk of becoming insolvent."

The terminology has been changed because, based on the amendment, the terms "at risk of becoming insolvent" and "impending insolvency" are defined in the Act on Bankruptcy and Restructuring.

Impending insolvency. According to Article 4 of the Act on Bankruptcy and Restructuring:
1. A debtor is **at risk of becoming insolvent** especially if they are **at risk of being unable to pay their debts as they fall due**.
2. A debtor is **at risk of being unable to pay their debts as they fall due** if, considering all circumstances, there are grounds to assume that, within 12 calendar months, they will be unable to pay their debts as they fall due.

This means that whereas:
- **insolvency** continues to be related to over-indebtedness and the inability to pay debts as they fall due,
- **impending insolvency** is related solely to the (impending) inability to pay debts as they fall due.

In this context, please note that the **definition of the inability to pay debts as they fall due** in Article 3 (2) of the Act on Bankruptcy and Restructuring has been changed, as well (among other things, the number of days was changed from 30 to 90): A legal entity is unable to pay its debts as they fall due if it is unable to repay at least two monetary liabilities, which are **90** days overdue, to more than one creditor.

Preventive procedures. Article 1 (1) of the Act on Solving an Impending Insolvency defines preventive procedures as:
- public preventive restructuring,
- nonpublic preventive restructuring.

This Act will not be further discussed in detail. Below are the general provisions contained in the **Explanatory Report** on the draft Act:
- In accordance with the principal objectives of the Directive, new legislation has been drafted to address the situation of an entrepreneur being **at risk of becoming insolvent because of an impending inability to pay their debts as they fall due**, namely within the framework of preventive procedures, which represent an effective tool to early solve the debtor's situation so that they can continue as a going concern and maintain their viability and, in particular, avoid insolvency and subsequent bankruptcy.

- **Preventive procedures** mean public preventive restructuring or nonpublic preventive restructuring.

- Therefore, the principal objective of the draft Act is to allow debtors enough space for efficient, effective, fast, and transparent **preventive restructuring** at an early stage, when insolvency is "impending," and thus prevent the debtor from becoming insolvent and solve their situation by means of an insolvency procedure, which should also help to prevent job losses and the loss of know-how and maximize the total value to creditors, in comparison to what they would receive in the event of bankruptcy, and to prevent the build-up of nonperforming loans.

KPMG

© 2022 KPMG Slovensko spol. s r.o., a Slovak limited liability company and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- To achieve this goal, the institution of **so-called interim protection** has been defined to actually provide the time needed for effective restructuring and achieving the objective pursued by public preventive restructuring, while the interim protection regulated by Act No. 421/2020 Coll. on the Interim Protection of Entrepreneurs in Financial Difficulties and on Amendments to Certain Laws has been repealed.

- Solving an impending insolvency via preventive procedures is only allowed in the case of a debtor that is a **legal entity**, and entities whose insolvency is impossible to solve in proceedings referred to in Act No. 7/2005 Coll. on Bankruptcy and Restructuring and on Amendments to Certain Laws as amended (hereafter referred to as "Act No. 7/2005 Coll.") are excluded from preventive restructuring.

- In addition to the above, the draft Act also regulates **so-called early warning tools** to early warn an entrepreneur that it is necessary to take necessary and appropriate action to avert an impending insolvency or insolvency.

KPMG
© 2022 KPMG Slovensko spol. s r.o., a Slovak limited liability company and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Subscribe to our newsletter and stay update on the latest developments in tax & legal area.

SUBSCRIBE NEWS

Contact

Ivana Mazániková
Partner

Andrea Šikulová
Senior Manager

Richard Farkaš
Retired Partner/Consultant

KPMG in Slovakia
Dvořákovo nábrežie 10
811 02 Bratislava Slovakia

T: + 421 2 5998 4111
E: kpmg@kpmg.sk
kpmg.sk

© 2022 KPMG Slovensko spol. s r.o., a Slovak limited liability company and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The information contained herein is of general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information will continue to be accurate in the future. No one should act on such information without appropriate professional advice and a thorough examination of the particular situation.