Horwath

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Talking Companies

The Solvency & Liquidity Test in terms of the Companies Act 2008 ("the Act")

The solvency and liquidity test must be satisfied by all companies after the implementation of a proposed amalgamation or merger transaction.

The solvency and liquidity test is satisfied by a company if, considering all reasonably foreseeable financial circumstances of the company at the particular time:

- The company's assets, exceed its liabilities; and
- It appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after the date on which the test is considered.

Any financial information concerning the company to be considered, must be based on accounting records and financial statements that meet the requirements prescribed by the Act.

The board or any other person applying the solvency and liquidity test to a company:

- Must consider the fair values of the company's assets and liabilities, including any reasonably foreseeable contingent assets and liabilities; and
- May consider any other reasonable valuation of the company's assets and liabilities.

A "liability" of a company may be defined as "any present obligation of a company arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits" (i.e. the transfer of an asset having value from the company to a third party)

The solvency and liquidity test must also be satisfied by the company when one of the following transactions is proposed:

- A distribution by the company which includes:
  - payment of a dividend;
  - payment, in lieu of the issue of capitalisation shares (i.e. shares issued to an existing shareholder instead of the payment of a dividend);
  - re-acquisition of the company's own shares;
- The provision of financial assistance to a party acquiring shares issued by the company;

The 12 month period in respect of which the company must be able to meet its liabilities as they become due commences from the date on which the distribution is made, or the financial assistance is provided, as the case may be.

Unless the Memorandum of Incorporation of the company provides otherwise, when a person applies the solvency and liquidity test to a distribution, any liability that would arise in respect of any right of a shareholder to receive a preferential dividend over the liquidation dividends to be made to all other shareholders must not be included in the calculation of the liabilities of the company.

If the company involved in a transaction where the solvency and liquidity test is to be applied is a holding company, the consolidated assets and the consolidated liabilities of that company are to be considered.

If a company is required, by a dissenting shareholder exercising his appraisal rights, to purchase the shares of that shareholder, and the company is able to show that it will not be able to satisfy the solvency and liquidity test after paying that shareholder, that company is entitled to apply to a court for relief regarding the basis on which it must pay the dissenting shareholder for the repurchase of the shares.

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