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M^CGRATHNICOL

CORPORATE ADVISORY

**Katungul Aboriginal Corporation
Community and Health Services**

Department of Health and Ageing

13 October 2011

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1 Scope and disclaimer

1.1 Scope

McGrathNicol was engaged by the Department of Health and Ageing ("the Department") to undertake a review of documents held by the Department in relation to Katungul Aboriginal Corporation Community and Health Services ("Katungul") and to provide an opinion as to whether that organisation may be insolvent.

1.2 Disclaimer

This report has been prepared for the Department in accordance with the Official Order dated 12 October 2011 and should not be used for any other purpose or provided to any other party except as required by law, without our prior written consent.

We have not carried out a statutory audit and accordingly, an audit opinion has not been provided. The scope of our work is different from that of an audit and it cannot be relied upon to provide the same level of assurance as an audit. Our conclusions are based solely on the information provided to us. We reserve the right to amend any conclusions, if necessary, should any further information become available. We further note that this report has been prepared on a desk-top basis only and there has been no interaction with Katungul's Board or staff. Accordingly, some of the conclusions reached may change if clarity to certain aspects of our analysis could be provided.

We have included within this report financial forecasts that by their nature are inherently uncertain. No reliance can be placed on these forecasts by any party.

Neither the firm nor any member or employee of the firm undertakes responsibility in any way whatsoever to any person or organisation other than the Department in respect of the information set out in this report, including any errors, omissions or negligence however caused.

1.3 Report contacts

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2 Analysis of financial position

2.1 Solvency framework

A company is regarded to be insolvent if it is unable to pay its debts when they become due and payable¹. Whilst we understand that Katungul is an organisation operating under the Corporations (Aboriginal and Torres Strait Islander) Act, and is not a company subject to the Corporations Act 2001, we have used this definition of solvency to guide our analysis below.

Accordingly, if an organisation cannot meet payments to creditors, staff, suppliers or lenders when these liabilities are due to be paid then it is insolvent.

Therefore, in determining whether Katungul is insolvent, consideration must be given to:

- + the current cash position of the organisation;
- + liabilities that are due and payable;
- + ability to access cash; and
- + cash flow forecasts.

2.1.1 Current cash position

From our review of the information provided to us, we note:

- + Katungul's balance sheet in MYOB as at 31 August 2011 reported a negative cash balance of \$121,502. This appears to be a reconciled cash balance (i.e. incorporates cheque payments that have not yet been presented).
- + A bank statement dated 26 September 2011 indicated that at that date Katungul had a bank overdraft balance of \$200,821. For completeness we note that approximately \$910 is held in two other accounts, leaving a total overdraft position at 26 September of \$199,911.
- + We have not been provided with a reconciled cash balance at the end of September. The absence of a bank reconciliation means that the actual cash position may be worse (or better) than the overdraft balance as presented on the bank statement.
- + Katungul sought an additional \$50,000 on its overdraft facility in August 2011. This appears to have been approved by the NAB in September 2011 with Katungul's overdraft facility temporarily increased to \$250,000. An email from the NAB indicates that the temporary increase of \$50,000 is due to be repaid on 15 October 2011.

From our discussions with the Department, we understand that Katungul had wage payments due to staff on 30 September 2011. From recent Payroll Activity Statements in the MYOB accounting system, it appears that approximately \$40,000 cash would have been required to make this wage payment.

Accordingly, based on the information to hand, our best estimate of Katungul's cash position in early October 2011 is:

	Balance \$
Cash balance per bank statement of 26 September (unreconciled)	(200,821)
Estimated net wages required to be paid on 30 September	(40,000)
Estimated cash position in early October 2011	(240,821)

¹ Section 95A of the Corporations Act 2001.

In light of the above, it appears that in early October 2011, Katungul had approximately \$10,000 available on its overdraft facility (which had been temporarily increased to \$250,000). Please note that we have no visibility over the transactions on this account from 26 September 2011. Accordingly, further monies may have been deposited (or withdrawn), impacting on the account balance.

2.1.2 Amounts that are due and payable

Identifying liabilities of Katungul that are due and payable requires a degree of estimation. We have considered the 31 August 2011 and 30 September 2011 balance sheets of Katungul and the MYOB accounting system to identify amounts that appear to be either due and payable now or within the very short term.

Balance and basis for estimate	Estimate \$	Comments
Outstanding GST: + As at 30/9/11 GST payable of \$39,000 was recorded in the MYOB system.	39,000	+ Unable to determine if this amount was due and payable as at early October 2011. However, tax payments for the quarter ended 30 September 2011 are likely to be due to be paid in late October 2011.
Outstanding PAYG: + Per the payroll activity summaries in MYOB, an estimate of \$105,000 PAYG for the quarter ended 30/9/11 less \$42,000 that appears to have been paid during the quarter.	63,000	+ Unable to determine if this amount was due and payable as at early October 2011. However, tax payments for the quarter ended 30 September 2011 are likely to be due to be paid in late October 2011.
ATO running balance: + Unsure of nature of this liability but \$14,000 is recorded in MYOB at 30/9/11 as a payable.	14,000	+ Unable to determine if this amount was due and payable as at early October 2011. However, tax payments for the quarter ended 30 September 2011 are likely to be due to be paid in late October 2011.
Employee leave provisions: + Current liability of \$110,000 and non-current of \$21,000 per MYOB at 30/9/11.	0	+ Employee leave balances are unlikely to be immediately due and payable. These are ordinarily staggered throughout a year and paid as part of a fortnightly wage expense. We have assumed nil is immediately payable.
Invoice to Tarramotors: + We have noted an invoice from Tarramotors for \$123,000 in respect of Katungul's purchase of a bus.	123,000	+ Unable to determine if this amount is due and payable as at early October 2011. However, the invoice is dated 26 August 2011 and we would assume that this is an amount that is currently payable.
Temporary overdraft with NAB: + NAB's additional \$50,000 facility was due to be repaid on 15 October 2011.	50,000	+ Due and payable on 15 October 2011.
Wages: + We understand that wages are due to be paid on 14 October 2011. Net wages (i.e. cash required immediately) is estimated to be \$40,000 based on recent wage payments.	40,000	+ Due and payable on 14 October 2011.
Loan from CEO: + We understand that the CEO of Katungul lent \$50,000 to the organisation in September 2011. We are unsure of the terms of this loan.	0	+ Unable to determine if due and payable as at early October 2011. The loan agreement governing this arrangement would need to be considered. We have assumed that this is not currently due and payable.
Total	329,000	

The above indicates that there is potentially \$329,000 in liabilities that appear to be due and payable now or payable in the very short term (i.e. before the end of October). There are likely to be further amounts due and payable (e.g. suppliers), however information was not to hand to understand the position of Katungul with respect to its suppliers.

The estimated cash position of Katungul in early October (i.e. overdraft of approximately \$240,000), indicates that Katungul may have difficulty in meeting their debts as they fall due. On the face of it, this implies that, in the absence of significant further cash being injected into the organisation, Katungul may be insolvent, or shortly about to become insolvent.

2.1.3 Ability for Katungul to access cash

It appears from the above that Katungul has an immediate need to access significant cash. Failure to inject cash into Katungul immediately may leave the organisation in an insolvent position.

We understand that the Department was due to make its quarterly payment to Katungul on 5 October 2011 in the amount of approximately \$470,000. We understand that this amount represents funding for the quarter commencing 1 October 2011 and ending on 31 December 2011. We are instructed that this payment has not yet been made by the Department.

Receipt of the Department's quarterly funding instalment would immediately reduce pressure on Katungul and enable it to pay creditors (including the list identified above). Whilst this is an immediate positive for Katungul, if the Department's funding is to be used to pay historic debts, consideration must be given as to how Katungul can continue to fund its operations in the longer term.

That is, it appears from the financial position of Katungul, that receipt of the Department's funding may do little more than pay existing debts leaving their ability to fund the next three months' operations in question.

We are uncertain of Katungul's ability to raise funds from other sources in the immediate timeframe required. We note:

- + Katungul has previously mortgaged their premises to NAB to provide security to the bank for their overdraft. Accordingly, we are unsure of their capacity to raise further debt funding from the NAB or any other source.
- + We understand that Katungul's CEO has recently injected \$50,000 into the organisation. We are unsure of Katungul's ability to raise further funding from other stakeholders (i.e. equity funding).
- + We are unsure of whether Katungul has surplus assets that it could sell quickly.
- + We are unclear on the timing or quantum of funding from the New South Wales State Government.

In the absence of significant injections of cash, it is unclear as to how Katungul will be able to meet its existing debts and fund ongoing operations.

2.1.4 Cash flow forecasts

As noted above, in the absence of an immediate significant cash injection, Katungul may be insolvent or about to become insolvent. Whilst a cash injection may bring Katungul back into a solvent position, consideration must be given as to whether Katungul is financially viable (i.e. can it remain solvent in its present form).

McGrathNicol has not undertaken cash flow forecasting in respect of Katungul's ongoing operations. Accordingly, we are unable to make any conclusions as to the longer term viability of the organisation.

Given the apparent cash position of Katungul, the board should undertake detailed cash flow analysis and forecasting. The board must determine whether:

- + Katungul can meet its debts as and when they fall due (i.e. whether Katungul is solvent);
- + Whether cash can be sourced immediately by Katungul; and
- + If cash can be sourced immediately to pay existing creditors, whether Katungul has a sustainable and viable business that can continue to provide their services and meet their debts as they fall due. Robust cash flow forecasts are required by the board to identify timing of cash receipts and cash payments to enable an informed decision to be made as to the sustainability and viability of Katungul over the short term and longer term.

The Directors of Katungul must also consider the financial position and solvency of Katungul in light of their duties and obligations as directors of the entity. Specifically, directors should be mindful of the insolvent trading provisions of the Corporations Act 2001 (by reference from their obligations under the Corporations (Aboriginal and Torres Strait Islander) Act).

3 Conclusions

McGrathNicol has undertaken a desktop review of Katungul in order to consider whether the organisation is likely to be insolvent. Our review has been limited to information provided by the Department, which has been sourced from Katungul. McGrathNicol has not had the opportunity to discuss any aspect of Katungul's financial position, or the financial information reviewed, with the board or staff of Katungul.

From our high-level analysis we note:

- + The information to hand suggests that Katungul may have had a bank overdraft of approximately \$240,000 in early October 2011.
- + An estimate of the liabilities that appear to be due and payable now, or in the very short term, amounts to approximately \$329,000.
- + In the absence of an immediate cash injection, Katungul may be unable to pay its debts as and when they are due.
- + Accordingly, in the absence of an immediate cash injection, Katungul may be insolvent or likely to become insolvent in the very short term.
- + If the Department was minded to pay the quarterly funding instalment of approximately \$470,000 in early October 2011, there is the potential for this amount to be used by Katungul to meet their existing debts rather than to fund ongoing operations for the next quarter.
- + McGrathNicol has not undertaken cash flow forecasting in respect of Katungul's ongoing operations. Accordingly, we are unable to make any conclusions as to the longer term viability of the organisation.
- + Given the apparent cash position of Katungul, the board should undertake detailed cash flow analysis and forecasting. The board must determine whether:
 - Katungul can meet its debts as and when they fall due (i.e. whether Katungul is solvent);
 - Whether cash can be sourced immediately by Katungul; and
 - If cash can be sourced immediately to pay existing creditors, whether Katungul has a sustainable and viable business that can continue to provide their services and meet their debts as they fall due. Robust cash flow forecasts are required by the board to identify timing of cash receipts and cash payments to enable an informed decision to be made as to the sustainability and viability of Katungul over the short term and longer term.
- + The Directors of Katungul must consider the financial position and solvency of Katungul in light of their duties and obligations as directors of the entity. Specifically, the directors should be mindful of the insolvent trading provisions of the Corporations Act 2001 (by reference from their obligations under the Corporations (Aboriginal and Torres Strait Islander) Act).
- + The Department may wish to obtain greater clarity from Katungul on the above issues of solvency and financial viability prior to paying their quarterly funding instalment. Based on the high-level information reviewed in the time available, there is a risk that the Department's funding instalment may be used (in part) to pay existing debts of the organisation leaving Katungul in a position where they may be unable to sustain future operations in the absence of obtaining further funding or accessing additional cash from other sources.