THE CORRELATION BETWEEN A COMPANY'S THREATENING INSOLVENCY AND ITS DIRECTOR'S LIABILITY 2.

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The present study is a continuation of the paper published in Issue 4/2015 of *Economy & Finance*. In the first part, I discussed the scope of a company director's liability towards both the company and its creditors; the procedure for asserting a director's liability for damages towards creditors under Section 33/A of the Bankruptcy Act; definitions of insolvency and of a situation threatening insolvency; and the concept of threatening insolvency as elaborated in the practice of the courts. In this second part of the paper, I deal with the methods of examining a situation threatening insolvency, and – citing a number of judgements by way of illustration – present the procedure for determining a director's liability.

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3.3 The method of examination of a situation threatening insolvency

3.3.1 Analysing current assets

It would be naïve for us to think that the debtor's threatening insolvency can be determined purely on the basis of whether the debtor possesses the liquid assets necessary to settle its debts by the due date, as establishing the threat of insolvency beyond any doubt requires an investigation broader in scope. In its ruling no. 15.Gf.40.503/2014/8 (based on the opinion of the auditor assigned to the case), the Budapest Court of Appeal also established that: **"Although threatening insolvency is closely connected to the liquidity situation, it cannot be mechanically identified with it."** I have seen the balance sheets of countless prosperous companies, but never one in which liquid assets surpass total short-term liabilities. If it were sufficient to compare only these two line items on the balance sheet, it would be possible to demonstrate that, at the time of writing the present study, the overwhelming majority of Hungarian enterprises find themselves in a situation threatening insolvency.

An examination of the fact and date of occurrence of a situation threatening insolvency must primarily begin with an inspection of the debtor's financial statements submitted under accounting law for the years preceding liquidation, published for the period embracing the time of the actions for which the director is held accountable. The balance sheet, in keeping with the principles enshrined in accounting law, is a statement of the company's financial standing, prepared according to accounting regulations, which – if it has been drawn up in conformity with these regulations – paints a true and reliable picture of the company's financial standing. The yearly balance sheet, annualized to the accounting date of 31 December of the year in question, presents the value and composition of the debtor's worth, broken down into the various line items on the assets and liabilities sides. Although the annual balance sheet represents a primary point of departure in examining the situation threatening insolvency, it provides only an approximate picture of the debtor's financial situation. First of all, the amount of the debtor's liquid assets must be compared with the sum of its short-term liabilities. Should short-term liabilities exceed liquid assets in magnitude, then this indicates the existence of a situation threatening insolvency.

According to Section 23, paragraph (1) of the Accounting Act, invested assets and current assets held or used by an enterprise for its operations must be shown under assets on the balance sheet. Invested assets serve the company's operations for a period of not less than one year. In examining an enterprise's short-term liquidity, the stock of current assets shown on the assets side of the balance must be compared with the short-term liabilities shown on the liabilities side, since these two balance sheet items play a role for a period of less than one year. Current assets include inventories, receivables, securities and liquid assets.

The goal of comparing current assets with short-term liabilities is to establish whether current assets cover short-term liabilities. Within current assets, the proportion and value of inventories and receivables must be appraised. It is necessary to assess how long it will take for inventories to be sold and what is their turnover rate, as well as how long receivables have been due; in other words, to make an overall assessment of how quickly these current assets can be converted into cash. In a strict sense, it is only cash assets in hand which can surely cover short-term liabilities in all circumstances, while the stock of receivables and inventories cannot provide a similarly sure answer. If the value of current assets falls short of short-term liabilities, then it can be ascertained that the company's assets designated for a period of less than one year were insufficient to settle its debts due within one year, and that a situation threatening insolvency has thus come about.

A company's balance sheet data offer only a point of departure or reference in appraising the company's financial situation or potential threatening insolvency. Although the company's balance sheet liabilities can be precisely determined in

Hungarian forints, the book value of its assets may differ significantly (in either a positive or negative direction) from the true market value, particularly if the assets include company equities, inventories or receivables because the debtor is operating a manufacturing facility.

Within assets, receivables are perhaps the most difficult to evaluate, given that this depends on the method of evaluating assets applied in the company's accounting policy, and furthermore on how long receivables have been due; how successful measures aimed at collecting them have proven; whether the party liable for the debtor's receivables has entered liquidation; and whether, in this regard, the debtor's director could have expected the receivables to be settled within a short period of time, thus enabling its suppliers to be paid. If the balance contains a significant amount of receivables, possibly even exceeding the debtor's total short-term liabilities, and if the party liable for the receivables has entered liquidation, the only conclusion that can then be drawn is that the debtor's director could surely not have expected the receivables to be settled within a short period of time, and certainly not in their entirety. It is necessary to determine whether the company's debts have been rescheduled, and if so, with what repayment deadline, while also establishing how long the debts have been due and what proportion of the company's worth they represent. It is also expedient to determine when creditors submitted an application for liquidation against the debtor, and how many creditors submitted such an application. The assessment must also reveal whether enforcement procedures have been initiated against the debtor, and if they have, then at what point in time, while the evolution of the company's balance sheet profit/loss and equity must also be examined.

It must not be forgotten that short-term liabilities include both liabilities which are already due and those which are not yet due; although, from the point of view of a pending threat of insolvency, it is primarily the mature debts that carry significance, or more precisely the question of whether the debtor holds sufficient liquid assets to settle these due debts. The balance sheet is drawn up only for a specific accounting date, and data projected for a specific date must therefore be handled with caution in assessing the solvency of a company. It is conceivable that short-term liabilities on the balance sheet mature in January of the following year, and that the debtor has already settled these liabilities.

Besides the balance sheet itself, it is also prudent to examine the supplementary appendix, in which we may likewise find data that point to threatening insolvency, e.g. liquidity indicators or statements referring to the debtor's financial situation, such as I myself have encountered: "The debtor's liquidity has deteriorated compared to the preceding year, and it will only be able to fulfil its obligations by taking out a loan."

Usable evidence includes the detailed general ledger or supplier analytics, from which it is possible to determine, for example, how great a debt each creditor (supplier) claimed from the debtor, how long it had been due, when this debt was settled – if it was settled at all – and whether the given creditor made a creditor's statement of claim under the liquidation process.

During a company's operation, a situation threatening insolvency arises from the date (period), only approximately determinable by calendar day, from which time the director could have known – or at least should have known – that the company will be unable to discharge its liabilities. The occurrence of threatening insolvency must be examined in terms of the awareness and knowledge of the facts on the part of the debtor's director. In order to avoid a situation threatening insolvency, the director must continuously monitor the company's due and overdue debts, as well as its cash flow statements. When establishing the director's responsibility, therefore, it is necessary to examine the substance of the director's knowledge; in other words, whether they must reckon with the possibility of a well-founded liquidation procedure being initiated against the debtor within *the foreseeable future*. "The notion of the foreseeable future applies to the period of time available to the director within the given financial year for realistically viable measures aimed at avoiding insolvency."[1]

It does not necessarily follow from a situation threatening insolvency that the court will surely order the debtor's liquidation within a short time. It is also conceivable that a debtor that has plunged into a situation threatening insolvency will continue to operate for years before liquidation is ordered. One possible reason for this is that a creditor with a due claim against the debtor has filed suit, but that a drawn-out delay ensues in reaching a judgement against the debtor in this court action. In addition, it is conceivable that the creditor with a due claim has not submitted an application for liquidation – for a protracted period of perhaps even years – because the debtor has dangled the prospect of partial performance of its obligations or enticed the creditor with the promise of a new contract. It is not uncommon for a creditor to enter into a contractual relationship with a debtor company which, despite being in a latent situation threatening insolvency, remains in operation and production.

3.3.2 Liquidity indicators

The **short-term financial situation** – liquidity – of enterprises can be measured and analysed with the help of various liquidity indicators. Evaluation of the liquidity status means comparing liquid assets and short-term liabilities (falling due within one year).

1 Budapest Court of Appeal, 15.Gf.40.172/2013/6.

The **liquidity ratio** is one of the most widespread indicators of liquidity. The liquidity ratio is calculated by dividing current assets (otherwise known as short-term or liquid assets) by short-term liabilities (short-term or current liabilities). Thus the liquidity ratio = current assets / short-term liabilities. This indicator therefore expresses how many times the value of current assets (regarded as liquid assets) cover liabilities due within one year. This ratio reveals whether the company is theoretically able to pay off its short-term liabilities (debts to suppliers, loans) from its current assets (cash, inventories, trade receivables). If its value is less than 1, then there is an immediate danger of insolvency, which means that the enterprise would be unable to pay off all its short-term debts if these abruptly needed to be settled all at once. Although a value of less than 1 can be taken as an alarm signal, it does not mean that the company will immediately become insolvent. At the same time, one must proceed with great circumspection in interpreting the liquidity ratio. A value of this indicator above 1 is acceptable – while the general view is that a value of around 1.5 can be regarded as adequate during the normal course of business. The company's creditors (mainly its short-term creditors) naturally see the highest possible liquidity ratio as desirable. However, a high liquidity ratio does not in itself ensure that the company is truly able to fulfil its obligations in the short term, as this depends on the one hand on the composition of current assets, and on the other hand on the turnover rate of current assets – particularly inventories and receivables. If the proportion of the latter is high and their turnover rate low, the company may experience payment problems even with a high liquidity ratio. A good example of this is an enterprise which, despite having a high liquidity ratio, also holds a large stock of receivables that are hard to collect or inventories that are hard to sell. When assessing an enterprise's liquidity, it is expedient to compare its liquidity ratio with that of other similar companies, thus taking into account the industry average and characteristic traits.

The composition of current assets is decisive from the point of view of liquidity. Compared to the liquidity ratio, the **quick liquidity ratio** differs in that inventories are omitted from current assets. The quick liquidity ratio reveals to what extent the company is theoretically able to pay off its short-term debts from the most liquid of its current assets. Thus the quick liquidity ratio = (current assets minus inventories) / short-term liabilities. (The reason for leaving out inventories is that the enterprise needs them in order to continue its activities.) If the value of the quick ratio is below 1, then the company is unable to pay off its short-term debts (assuming that these are to be paid all at once). As court-appointed auditors have pointed out in legal proceedings, it is not absolutely necessary for this indicator to be above 1 at companies with good business operations. (If a big difference exists between the liquidity ratio and the quick ratio, this means that the firm has significant inventories and is largely dependent on these.) In suit no.

15.Gf.40.503/2014/8 heard before the Budapest Court of Appeal, the appointed auditor took the position that "at companies with good business operations, the value of the quick liquidity ratio is acceptable above 0.7."

3.3.3 On the need for auditor's evidence

"Based on the provisions of Section 33/A of the Bankruptcy Act, assessing whether the representative's activity was contrary to creditors' interests, as well as the extent of the reduction in the company's worth that can be attributed to this activity, is a **complex economic question.** It is precisely for this reason, in a lawsuit of this type, that **auditor's evidence must generally be used to clarify when the situation threatening insolvency arose,** and subsequently what economic events occurred and what conduct on the part of the director was appropriate to the protection of creditors' interests; furthermore, it is necessary to establish the precise extent of the reduction in the company's worth due to the wrongful conduct of its director."[2] "When establishing threatening insolvency in legal proceedings, recourse to the tool of auditor's evidence is frequent, but not indispensable."[3] In some cases, courts determine the date of occurrence of a situation threatening insolvency by calendar date, while in other cases it is narrowed down only to a certain period, e.g. a designated month or quarter in a given year by which time the threat must surely have been present.

In so far as a situation threatening insolvency can be determined, a distinction must be drawn between simpler and more complex cases. Establishing the occurrence of a situation threatening insolvency exclusively on the basis of balance sheet data – and to a degree of certainty permitting a judgement to be made – is possible, for example, when the balance shows total short-term liabilities significantly exceeding liquid assets (at the time of the disputed measures taken by the director); when the debtor has no tangible assets, inventories or receivables, or when the total amount of these falls significantly short of the total stock of liabilities; if the debtor was no longer carrying out economic or production activity and had no employees; or if it was subject to enforcement procedures or a punitive judgement in a lawsuit. Courts do not deem auditor's evidence necessary in the event that the company director's actions ran counter to creditors' interests at a time when enforcement procedures had already been initiated or an application for liquidation already submitted against the debtor, since in this case the company's insolvency could already be established according to Section 27, paragraph (2) of the Bankruptcy Act. The appointment of an auditor is justified in the event that the debtor was still carrying out significant economic or production activity; if it continued this activity after taking actions counter to creditors' interests; or if

2 Case no. IH 2012/91, Szeged Court of Appeal, Gf.III.30.403/2014/8; Gf. III. 30.439/2013/4.

3 Budapest Court of Appeal, 15.Gf.40.257/2015/4/II.

it still had employees, continued to operate for a protracted period, and continued to make regular payments to its suppliers.

3.4 Court rulings

By way of illustration of the process of examining a situation threatening insolvency, I present some relevant court rulings.

3.4.1 According to the statement of facts in ruling no. *Gf.II.30.266/2009/7 of the Pécs Court of Appeal* (BDT. 2010.2282.), the debtor's managing directors decided to extend a loan of HUF 24.5 million at a time when several creditors held a legally binding payment summons or had initiated an enforcement procedure against the company under their management, on which basis the company's liquidation could also have been ordered, meaning that the company was thus insolvent at the time of the loan's extension.

In its ruling in principle, upheld by the Pécs Court of Appeal and affirmed by the Curia as Hungary's supreme court (published under EBH 2011. 2326.), the court of the first instance determined that defendants I. and II., as managing directors, had failed – subsequent to the occurrence of a situation threatening insolvency at the debtor – to carry out their management tasks based on the primacy of creditors' interests, bringing a reduction in the company's worth of a total of HUF 24,500,000 as a consequence. Defendant I. was the debtor's managing director from 13 January 2003 to 2 August 2007, alongside defendant II. from 16 June 2004 to 16 April 2007. Defendant I. was a partner of B.P. Kft. from 29 December 2006, and its managing director from 10 May 2005. On 19 December 2006, the debtor extended an interest-free loan of HUF 24,500,000 to B.P. Kft., setting a repayment date of 31 December 2007. At the time the loan agreement was concluded, defendant II. was also a managing director of the debtor company. At the time of the loan's extension, the debtor was carrying out no substantive activities, the project for which it was established having already been completed prior to the conclusion of the loan contract, and it subsequently had no revenues. At the time of the loan contract's conclusion, the debtor had debts determined in legally binding court rulings and a decision of the tax authorities, and partly subject to an enforcement procedure. An application for liquidation was submitted against the debtor on 21 April 2007, and the liquidation procedure began on 2 August 2007.

The debtor's liquidator cancelled the loan contract on 26 October 2007, at the same time announcing a creditor's claim in the final settlement procedure launched against the borrower B.P Kft. An application for liquidation was sub-

mitted against B.P. Kft. on 9 May 2007, with the court ordering the firm's liquidation with a start date of 8 February 2008. The loan of HUF 24,500,000 extended by the debtor was not recovered in the course of the borrower's liquidation procedure, so that the creditor, as plaintiff, asked that the liability of the defendant managing directors be established to the amount of this reduction in assets.

The court of the first instance determined that at the time the loan was extended, on 19 December 2006, the debtor was in a situation threatening insolvency. The court took as its starting point the debtor's balance sheet drawn up with an accounting date of 31 December 2006, which revealed invested assets to the value of HUF 526,000, consisting of intangible assets worth HUF 55,000 and tangible assets worth HUF 471,000. Of current assets totalling HUF 24,736,000, receivables amounted to HUF 24,709,000 and cash HUF 27,000. (Receivables included the HUF 24,500,000 claim against B.P. Kft.) The debtor's de facto overdue principal amounted to HUF 20,703,563. The tax liability, falling due and subject to enforcement after 19 December 2006 but before 20 April 2007, prior to submission of the application for liquidation, amounted to HUF 2,053,645, bringing total overdue debts to HUF 22,757,208. Consequently, the debtor's outstanding debts at the time of extending the loan, together with interest, actually exceeded the amount of the loan extended to B.P. Kft. With respect to several overdue claims subject to enforcement, it would have already been possible to establish insolvency, so that at the time the loan was extended "the company was partly insolvent, and partly in a situation threatening insolvency, since the directors of the company were – or should reasonably have been – able to foresee that the company would not be able to settle the claims against it when due. The company did not pay off its overdue debts either, although the director cannot have weighed whether to pay off its debts or invest the company's money." All these things taken into account, the court did not deem the appointment of an auditor to be justified.

3.4.2 According to the statement of facts in ruling no. *Gf.IV.30.540/2013/7 of the Debrecen Court of Appeal* (BDT. 2014. 3144.), the debtor incurred a tax debt of HUF 474 million following fulfilment of building contracts concluded with local governments. On 6 April 2009, one of the banks concerned initiated a liquidation procedure against the debtor with respect to a debt of more than HUF 400 million. The court ordered the liquidation of the debtor with a start date of 3 September 2009. The tax authority, as plaintiff, carried out an official tax inspection at the debtor as part of the liquidation process. In the official report on this, it was established that in its balance sheet closing activities in 2009, the debtor accounted HUF 27,800,000 under the title of other extraordinary expenditures on the grounds of "loss of deposit." In a preliminary sale and purchase agreement concluded on 8 June 2009, the debtor signalled its intention to buy a property

designated as a house and courtyard for a purchase price of HUF 82 million. According to the preliminary agreement, the date for signing of the final sales contract would have been 31 August 2009. On this day, the seller and buyer (debtor) signed a document terminating the sales contract, in which they set down that the seller would not repay the amount of the deposit received in cash from the buyer because the buyer had failed to keep to the payment deadline undertaken in the preliminary sale and purchase agreement. This document also specified that the termination of the preliminary agreement occurred on the grounds of withdrawal of the buyer (debtor).

In its statement of claim, the tax authority as creditor asked for it to be established that the defendant managing director had breached their obligations under Section 33/A of the Bankruptcy Act in handing over the deposit of HUF 27,800,000, and requested liability to be established to the amount of this reduction in worth. In its judgement the court of the first instance approved the statement of claim, and the Debrecen Court of Appeal subsequently hearing the defendant's appeal upheld this judgement. The courts determined that the debtor had been in a situation threatening insolvency from April 2009. This was chiefly corroborated by the applications for liquidation against the debtor submitted by several creditors at this time, signifying that the debtor did not then hold the sufficient liquid assets needed to pay off its debts. According to its closing balance sheet, the debtor held liquid assets of HUF 9,327,000 as of 31 December 2008, while its short-term liabilities totalled HUF 1,231,717,000. The defendant could not have reasonably expected the debtor's receivables to be returned as soon as possible because on 8 June 2009, prior to the concluding of the preliminary agreement, the debtor had already sold a claim totalling HUF 313,385,200 for HUF 47,007,780, while immediately after signing the preliminary agreement, on 7 August 2009, it sold a claim of HUF 49,588,394 for a mere HUF 1,105,000 (to a subcontractor, of which the defendant's close relative was a member and director). The defendant concluded the preliminary agreement in the debtor's name at a time and under circumstances when they knew (as they should have known with due circumspection) that liquidation procedures had been initiated against the debtor on account of several hundreds of millions of forints in overdue debt. The court furthermore found that the defendant, acting as buyer in the company's name, had initiated the withdrawal from the preliminary agreement. If proceeding with due care, the defendant managing director should have expected that there would be no way of paying off the arrears of the purchase price, and that the deposit amounting to the company's entire cash holding would be lost.

3.5 Enforcement by the liquidator of a claim for damages against a director

During the ordinary operation of a company or in the period extending right up until the start of the liquidation process, the company's members'/general meeting is entitled to decide on enforcement of a claim for damages affecting the company against its director, and the claim for damages may be enforced *exclusively* by the company. After the start date of the liquidation process, according to Section 27/A, paragraph (12) of the Bankruptcy Act, the liquidator becomes the debtor's legal representative, and for this reason it is the liquidator who decides whether to enforce the claim for damages in the debtor's name against the director who filled that position prior to liquidation. Enforcement of the damage claim against the director is also in the interests of creditors, since successful recovery increases the value of the liquidated assets. There is no obstacle to the liquidator enforcing a claim in the debtor's name for damages affecting the company when the underlying wrongful act (injuring the company's interests) was committed by the director *prior* to the occurrence of the situation threatening insolvency. In cases of internal liability, such legal actions may truly become most timely after ordering liquidation of the company declared insolvent, when the liquidator takes the place of the previous director (with the right to represent the company and control its assets), whose primary task is to represent the interests of creditors in the bankruptcy process, and who – by virtue of the *change in interest* occurring in the person of this representative, unique in our legal system – may question the past actions of management.

In its ruling no. EBH 2011. 2417, the Curia took the position in principle that: "The liability of the director may be established if, assessing the company's position and market circumstances entirely wrongly, the director undertook a foreseeable and flagrantly unreasonable risk. The director's conduct is actionable if he/she concludes a contract in an unfamiliar foreign language in such a way as to be unsure of its true legal content, or transfers a significant sum to a foreign-domiciled offshore company as contracting party without stipulating any kind of guarantee of performance, or guarantee in the event of performance becoming impossible." According to the facts of the case, the defendant was managing director of the plaintiff company under liquidation. Among other things, the plaintiff company was engaged in rock breaking. On 6 January 1998, a sales contract was concluded in English between a Bahamas-based company, as seller, and the plaintiff limited company, as buyer, for the purchase of a rock-breaking production line for the purchase price of USD 640,000. In accordance with the contract, the defendant transferred a total deposit of USD 150,000 to the seller's account on 12 January and 26 January 1998. The deadline for performance of the contract was 28 February 1998, which was amended by the parties to 31 March 1998. Since the plaintiff buyer was not granted a bank loan, and was thus unable to settle the purchase

price, the seller did not deliver the machinery to the plaintiff, which thus lost its deposit. In the liquidation process initiated by the tax authority on 3 November 1998 following an unsuccessful enforcement procedure, the court began liquidation on 18 January 2001.

The debtor represented by the liquidator, as plaintiff, in its statement of claim submitted on 1 July 2004, asked that the court compel the defendant managing director to pay HUF 59,527,000 (equivalent to the value of the lost deposit) plus default interest. The court of the first instance ordered the defendant to pay costs according to the claim. The justification for the ruling stated that "Act IV of 2006 on Business Associations expects a due level of care from the person filling the given position, so that the managing director – when assuming his office – must consider whether he possesses the capabilities and knowledge required for the management of a company. *It is expected of the managing director that he chooses his business partners carefully; that he should not assume any risk of a magnitude exceeding customary business risk; that he should maintain documentary discipline to ensure continuous review of the company's financial situation;* and that, once liquidation has been ordered, he should place comprehensive documentation at the disposal of the liquidator in accordance with Section 31 of the Bankruptcy Act. It follows from this that the managing director must verify the content of the contract he signed, and that he proceeded with circumspection in signing the contract; that the transaction served the interests of the company, that proper certification of payments was drawn up, and that he took every necessary measure in order to enforce claims arising from the transaction." The defendant transferred the deposit at a time when it was not yet sure that the remainder of the purchase price would be covered. The defendant became familiar with the conditions of the loan contract on 22 December 1997, and knew from the outset that these could not be fulfilled, even indicating this to the bank. Despite this, the deposit was transferred a few days later to a Bahamas-registered offshore company. At the time of this payment, the plaintiff owed taxes. In this situation and with an uncertain credit assessment, the defendant undertook the obligation to pay some HUF 130 million within 50 days, as well as the possibility of losing a deposit of USD 150,000, for which the defendant bears responsibility. The court took into consideration the supplementary appendix to the company's 1997 balance sheet, in which the defendant reported on the company's business in 1997 by noting that "substantial competition has had such an impact on activity that sources of income greatly decreased by the end of the year, and the efficiency of further operation or possibility of realizing further revenues was cast in doubt. Liabilities took on greater proportions than accounts receivable, although the difference is covered by liquid assets. Profitability is not reassuring, and there is little to suggest good

prospects. Instability means there are no further investment plans." It can be gleaned from the facts of the case that the company was presumably in a situation threatening insolvency at the time of concluding the sales contract, but given that the signing of the contract harmed the interests not only of creditors but of the company itself, the liquidator could also have enforced the claim for damages – the eventual beneficiaries of which were the creditors – in the name of the company itself.

4. SUMMARY

The situation threatening insolvency therefore represents a definitive dividing line in the context of the director's liability, because it is from this point on that the director is obliged to carry out their management tasks based on the primacy of creditors' interests. Examination of a situation threatening insolvency means assessing the debtor's liquidity, i.e. its short-term solvency, but this assessment must ignore the company's invested assets, as only current assets carry relevance from the point of view of liquidity. The summarized concept, evolved through judicial practice and cited in the above, may be defined thus: "Regarding the possibility of establishing a situation threatening insolvency, the essential question is whether the debtor will be able to settle its debts by the due date." Although on this basis it may seem that the existence of threatening insolvency can easily be judged, the situation is more complicated, particularly if the investigation concerns the solvency of a company still in operation and production. Given that this is a complex question of economics, the court cannot omit to appoint an auditor in such cases. In judging the threat of insolvency, it should be emphasised that a lower amount of liquid assets compared to liabilities does not in itself necessarily mean that threatening insolvency can be established, as it is also necessary to assess the liquidity of other current assets and the turnover rate of inventories, as well as when receivables fall due. Taking a strict interpretation of the concept of threatening insolvency in the practice of the courts, and adapting this to Hungarian economic conditions, we may come to the conclusion that a significant proportion of companies in Hungary are essentially in a perpetual state of threatening insolvency, since enterprises short of capital can only settle the claims of the suppliers who are their creditors if they themselves receive payment for the goods they market or the services they provide. A lack of liquid assets does not necessarily signify the onset of threatening insolvency; however, when – for example – a given customer of the company is unable for whatever reason to settle a substantial debt (because, say, it becomes subject to liquidation or its credit line is terminated by the financing bank), then the company may immediately lose its

liquidity and drift to the edge of bankruptcy. From this point on, moreover, the director is obligated to refrain from taking any unwarranted or irresponsible risk during continued management of the company (for as long as the company does not regain its liquidity or its liquidation is not ordered); otherwise, they may be held liable for damages towards creditors at their own expense, up to the amount of the reduction in assets they have caused – an issue I intend to examine in a separate study.