

# JOINT INSOLVENCY EXAMINATION BOARD

*Joint  
Insolvency  
Examination  
Board*

Joint Insolvency Examination

Monday 3 November 2008

---

## **LIQUIDATIONS** **(3.5 hours)**

---

**ANSWER ALL FOUR QUESTIONS**

**QUESTIONS 1 AND 2 CARRY TWENTY MARKS EACH  
QUESTIONS 3 AND 4 CARRY THIRTY MARKS EACH**

**SUBMIT ALL WORKINGS**

**The Examiner will take account of the way material is presented. Candidates should answer the questions set - and marks will not be awarded for extraneous material.**

**The time allowance has increased to 3.5 hours to include half hour reading and compilation time, but candidates may write at any time during this period.**

**Note:** References to legislation are to that which was in force on 30 April 2008. References to 'the Act' are to the Insolvency Act 1986 as amended.

References to Sections, Schedules and Rules are to Sections and Schedules of the Insolvency Act 1986 and to Rules of the Insolvency Rules 1986 as amended.

References to Sections and Rules of other Acts, Regulations and Orders will mention the Act, Regulation or Order.

1. You are a licensed insolvency practitioner. In the past few months your firm's insolvency department has had very little new work.
- 1(a) You have the following (i, ii and iii) current and potential appointments to consider:
- (i) Hurr Limited ("the Company") has been in Members' Voluntary Liquidation for three months and you are the Liquidator. The Company was previously an audit client of your firm. You have received a large, previously unknown claim which on investigation you have found to be valid and which results in the Company being no longer solvent.

### Requirements

**Set out, with reasons, the steps that you, as Liquidator, should now take in the context of your statutory and professional obligations. (6 marks)**

- (ii) Your firm has carried out tax work for Bluefork Limited ("the Company") for the past five years, earning substantial fees in the first two years. More recently, the tax work has declined and fees for each of the last two years were £1,500. One of the directors of the Company is a good friend of the tax partner. At the request of one of your partners in the tax department, you spent half a day at the Company and have concluded that it is in the best interests of the creditors for the directors to place the company into Creditors' Voluntary Liquidation. There are uncharged assets of £500,000 and liabilities of £13,000,000. The Company's directors and shareholders have suggested that you be appointed Liquidator.

### Requirements

**Discuss, with reasons, the issues that you should consider with regard to your position as Liquidator designate. How, if at all, would your answer differ if your appointment were to be jointly with an insolvency practitioner from another firm? (5 marks)**

- (iii) You are the sole Administrator of Betterdays Ltd ("the Company"). Your statement of proposals as approved by the creditors' meeting provided for trading to be continued during the Administration and for the Company to enter Creditors' Voluntary Liquidation at the end of the Administration, with you, together with a licensed insolvency practitioner from another firm, as Joint Liquidators. It is proposed that the areas of responsibility for work will be appropriately split between the two Liquidators. A major unsecured creditor has complained to you about the conduct of the Administration and particularly about the decisions taken concerning trading and the quantum of the Administrator's fees.

### Requirements

**Discuss, with reasons, whether or not you may accept the appointment as Liquidator. (4 marks)**

- 1(b) Dahliarose Ltd ("the Company") made components for certain machine tools. It had been established for over 60 years and has had a reputation for producing high quality products. The Company was wound up by the Court on 27 October 2008, following a creditor's petition presented on 30 September 2008. The Company was still trading on 27 October 2008. You were appointed Liquidator, pursuant to section 137, on 3 November 2008 when you met the two directors and shareholders. The directors, who had spent most of October 2008 on holiday, claim that the first thing that they knew about the petition and winding up order was when they received a telephone call from the Official Receiver's office on 3 November 2008. You understand that the formalities of serving the petition and obtaining the winding up order were properly complied with. You ascertain that, although the accounting records and filing systems are in a disorganised state and the Company's liabilities exceed its assets, there is a strong order book. The only fixed assets which may have value are three machines but these can only be used to make the components for one customer.

There are two other machines used in the manufacture of different components but these are faulty and require expensive repairs. The other assets comprise stocks and work in progress with a book value of £2,000,000 and debtors amounting to £100,000. Motor vehicles are subject to hire purchase and have no residual value and there are no charged assets.

### **Requirements**

**Set out the steps that you, as Liquidator, may take to ensure a maximum return for creditors. Discuss the relative merits of any alternative courses of action. (5 marks)**

**(20 marks)**

2. George, Dorothy and Archie are the only shareholders and directors of GDA Garden Centres Ltd (“the Company”) which operates two garden centres – a large one outside town and a smaller one in the town centre. There had been a slow decline in sales for some time but they have fallen steeply in the last six months because of the opening, nearby, of a large national garden and DIY centre. The directors cannot match the prices of the competitor and, consequently, do not expect sales to improve.

The directors have asked you to take a look at the Company’s financial position. You ascertain that the books and records are up to date and the Company’s financial accountant has prepared the following accounts.

### Balance sheet, 31 October 2008

Ref to notes		£’000	£’000	£’000
	<b>Fixed assets</b>			
(i)	Tangible assets			1,870
	<b>Current assets</b>			
(ii)	Inventories	1,005		
(iii)	Trade and other receivables	160		
(iv)	Cash	15		
			1,180	
(v)	<b>Creditors: amounts falling due within one year</b>		<u>(2,785)</u>	
	Net current liabilities			<u>(1,605)</u>
	Total assets less current liabilities			265
(vi)	<b>Creditors: amounts falling due after more than one year</b>			<u>(1,100)</u>
	Net liabilities			<u><u>(835)</u></u>
	<b>Capital and reserves</b>			
	Called up share capital		100	
	Share premium account		100	
	Profit and loss account		(1,035)	
	Equity shareholders’ funds			<u><u>(835)</u></u>

### Income Statement for the year ended 31 October 2008

	£’000
<b>Revenue</b>	5,300
Cost of sales	<u>(3,100)</u>
<b>Gross profit</b>	2,200
Administrative expenses and depreciation	<u>(2,800)</u>
<b>Operating Loss</b>	(600)
Finance expenses – bank interest and similar charges	<u>(300)</u>
<b>(Loss) before taxation</b>	(900)
Taxation	<u>0</u>
<b>Loss for the year</b>	<u><u>(900)</u></u>

(i) **Tangible fixed assets** comprise

	<b>£'000</b>	<b>£'000</b>
Freehold land and buildings – out of town	600	
Freehold land and buildings – town centre	170	770
Fixtures & fittings		1,000
Motor vehicles		100
		<u>1,870</u>

The net book value of assets held under hire purchase contracts at 31 October 2008 is £100,000.

The bank holds fixed charges over the freehold and leasehold properties.

(ii) **Inventories**

Inventories are valued at the lower of cost or net realisable value.

(iii) **Trade and other receivables**

	<b>£'000</b>
Trade	50
Prepayments and accrued income	40
Deferred tax asset	70
	<u>160</u>

(iv) **Cash**

Cash is cash in tills.

(v) **Creditors amounts falling due within one year**

	<b>£'000</b>
Bank overdraft	615
Trade creditors	1,165
Other taxes and social security	820
Accruals and deferred income	155
Hire purchase creditors	30
	<u>2,785</u>

(vi) **Creditors amounts falling due after one year**

	<b>£'000</b>
Term loan	1,000
Hire purchase creditors	100
	<u>1,100</u>

## Additional information

- (1) Both of the garden centres are freehold. A chartered surveyor contact of yours has suggested that the out of town property is worth £700,000 and the town centre property is valued at £200,000.
- (2) Fixtures and fittings include sprinkler equipment purchased from Sprinklers Ltd in October 2008. Sprinklers Ltd has demanded that the equipment be returned to it, under a retention of title clause, for non-payment. The net book value and realisable value of this equipment is £200,000 and £20,000.
- (3) Fixtures and fittings also include greenhouses in the course of construction, with a net book value of £500,000. This figure comprises building materials and costs including £100,000 of capitalised interest costs on borrowings for the construction. Such interest costs are capitalised from the start of the project to the commencement of trading. A valuation agent has estimated the realisable value of the greenhouses to be 20% of the building costs.
- (4) The remaining fixtures and fittings have a negligible value.
- (5) The motor vehicles comprise three cars (book value £30,000), used by the directors, and two tractors (book value £70,000). The estimated realisable gross value of the cars and tractors is £25,000 and £20,000 respectively, whilst the respective amounts due under hire purchase agreements are £80,000 and £50,000.
- (6) Inventories are plants for resale and are shown in the balance sheet at cost. About 75%, by value, must be sold within two weeks before the plants start to deteriorate. The remaining 25% consist of more hardy plants which have a shelf life of around six months. The directors consider that, if sold at half price, the hardy plants will take less than two months to sell.
- (7) There are over 1,000 trade creditors. The book value includes £30,000 due to Weedy Supplier Ltd which the directors dispute, claiming that it relates to the supply of diseased plants. The inventory has been written off.
- (8) Accruals and deferred income includes £100,000 in respect of customer deposits in respect of a "Christmas Savings Club". The cash has been received, from local collection agents (after deducting a fee), from January 2008 to date and has been placed in the Company's bank account. In addition, the directors estimate that the agents currently hold cash of £20,000, including £2,000 fees.
- (9) The overdraft and term loan from TownCity Bank is secured by a legal mortgage on the freehold land and buildings at the out of town and city centre sites.
- (10) Other taxes and social security comprise £230,000 in respect of VAT, which is three months in arrears and £590,000 in respect of PAYE and NI, which is four months in arrears.
- (11) Arrears of wages are £50,000, accrued during the last month and not exceeding £800 per worker. (You may ignore other employee liabilities).
- (12) There is no floating charge.

## Requirements

Using the information provided in the draft balance sheet, profit and loss account and associated notes, and stating any assumptions made by you,

- (a) Prepare a statement of affairs for the Company as at 31 October 2008, making and explaining estimates of any contingent or prospective liability at a level that you regard as commercially realistic. (9 marks)
- (b) Prepare a deficiency account for the Company as at 31 October 2008. (4 marks)
- (c) State, with reasons and in the light of the tests laid down by the Act, whether or not you consider the Company to be insolvent. (4 marks)
- (d) Assuming that the Company is insolvent and that Liquidation is the best option, set out, with reasons, the procedure that you recommend in this case. (3 marks)

(20 marks)

3. On 1 September 2008, you were appointed Liquidator of Downtrodden Plc (“the Company”) pursuant to Schedule B1, paragraph 83. Previously, the Company entered into Administration on 2 September 2007, when you were appointed Administrator pursuant to Schedule B1, paragraph 22. During the Administration the preferential and floating charge creditors were paid in full (the floating charge was created on 20 April 1990). The £750,000 cash surplus at the end of the Administration was transferred to the Liquidation. The unsecured creditors, of £4 million, were admitted by the Administrator for voting purposes in accordance with Rules 2.38 and 2.39.

You wish to declare a dividend as soon as possible and have the following matters to deal with:

- (1) You, as the Administrator, have submitted an invoice, for £15,000, in respect of fees incurred during the Administration.
- (2) You, as Liquidator, have received an invoice for £2,000 in respect of electricity used during the Administration.
- (3) You have incurred time costs of £5,000 in the Liquidation and expect to incur a further £20,000.
- (4) You have received a demand, for £30,000 in respect of six months’ business rates for office premises that were vacated shortly before the end of the Administration. The rent and rates were paid up to the end of the Administration and the landlord is demanding £10,000 a month for rent. You disclaimed the lease on 1 October 2008. You understand that the landlord relet the premises on 3 October 2008.
- (5) The cash is kept in a bank deposit account which earns gross interest of approximately £1,100 per month.
- (6) The Company had issued 20,000 5% cumulative preference shares. At the date of Liquidation, the dividend for 2008 was outstanding but had not been declared.
- (7) One preference shareholder has written to you claiming that he is owed £120,000 comprising £110,000 which he lent to the Company in 2002 and £10,000 preference share dividend which was declared but not paid for in 2008.
- (8) At the date of Liquidation there are five ordinary shareholders each holding 4,000 £1 shares with 60 pence paid.
- (9) Smithjones Ltd has written to you claiming that it is owed £28,000 comprising two amounts of £10,000 and £18,000 which were invoiced on 31 July 2007 and 31 July 2008. Smithjones Ltd also appeared in the Company’s debtors’ ledger, on 2 September 2007, for £13,000.
- (10) An Italian creditor is owed Euros 50,000. The exchange rates on the date of purchase of the goods supplied, at the date of Liquidation and today are respectively £1 = Euros 0.69, £1 = Euros 0.75 and £1 = Euros 0.80.

### Requirements

- (a) **Set out the procedure generally for paying a dividend to creditors. (8 marks)**
- (b) **Set out how you would resolve the outstanding matters before agreeing and admitting creditors’ claims for dividend in this Liquidation. Calculate the amount available to pay a dividend. State any assumptions that you make. (12 marks)**
- (c) **Explain how the Italian creditor’s claim should be dealt with. (2 marks)**
- (d) **For each outstanding claim, calculate the amount which should be accepted by you, as Liquidator, or the further information required to calculate the amount. State your reasons and, where applicable, give calculations. (8 marks)**

**(30 marks)**

4. Until 2005, Leo, a builder, worked only as a sole trader. In 2005, Leo gained a larger than normal contract and had to sub-contract labour. Stephen, a builder friend, advised that Leo would be better off operating from a limited company. Leo purchased a “shelf” company in July 2005 and commenced trading LeoMol Builders Ltd (“the Company”) in July 2005 as well as continuing his business as a sole trader. Leo, his wife, Molly, and Stephen, are the only directors and shareholders of the Company which has £100 share capital. Leo holds 95% of the shares and Molly and Stephen 2.5% each.

Stephen is not involved with the daily running of the Company.

Leo is responsible for obtaining and carrying out the Company’s building work. As a sole trader he supplies the Company with sub-contract labour and machinery.

Molly is the Company Secretary and book keeper but knows very little about the corporate legal framework and has been struggling with the accounting. In July 2007 she employed Henry, a part-qualified accountant, as accounts manager.

Recently the Company has suffered severe cash flow problems.

You have the following information:

- (1) Since its inception the Company has paid £20,000 per month for use of various plant and equipment, including a JCB, which Leo owns.
- (2) The Company also pays the sub-contractors directly, even though Leo, through his business as a sole trader, is responsible for hiring them. Leo charges a management fee of £5,000 per month for arranging the sub-contractors. The sub-contractors are currently owed £100,000.
- (3) The only assets appear to be £15,000 in the Company’s bank account and debtors amounting to £50,000.
- (4) The Company has never prepared financial or management accounts and it is difficult to distinguish what work Leo does on his own account and what work he does for the Company.
- (5) Trade creditors are owed at least £3,500,000.
- (6) Stephen loaned the Company £40,000 in July 2005, for which he received 20% interest per annum. He had no security for the loan which was repaid in January 2008.
- (7) Inspection of the bank statements reveals:
  - that Molly and Stephen draw £1,000 per month each in salaries and Leo draws £5,000 per month salary.
  - a total dividend of £500,000 was paid to the shareholders in August 2008.
- (8) It appears that during the last year some of the Company’s cash receipts and some Company cheques were paid directly into Leo and Molly’s personal bank account. They maintain that the payments were made to finance the hiring of labourers, hire purchase payments for the machinery and other payments for the benefit of the Company.
- (9) Unknown to the directors, since November 2007 Henry had obtained further credit for the Company from key suppliers by giving them false accounting information. Henry had also been creating false supplier accounts and causing payments to be made into bank accounts which he had set up.
- (10) On 26 September 2008 a creditor, for £25,000, petitioned for the winding up of the Company. Since that date the following amounts have been paid out of the Company’s bank account:

Creditors	£165,000
Wages	£100,000
Happy Garages	£5,000
Leo	£70,000

The amount paid to Happy Garages was for repairing Leo's daughter's damaged car which her uncle had given her as a 21<sup>st</sup> birthday present in July. The £70,000 paid to Leo comprised his £5,000 monthly management fee plus £65,000 for work done on tendering, unsuccessfully, for a large contract.

### **Requirements**

- (a) Write a letter to the directors setting out their responsibilities in relation to the Company both as regards the past events described above and the recommended future course of action in the light of the present circumstances. (12 marks)**
- (b) Assuming that the Company is wound up by the Court on 10 October 2008, discuss what steps you, as Liquidator, may take to increase the amount available to creditors. Your discussion should compare remedies available. (12 marks)**
- (c) Discuss the problems associated with funding the steps discussed in b. (6 marks)**

**(30 marks)**