JOINT INSOLVENCY EXAMINATION BOARD

Joint
Insolvency
Examination
Board

Joint Insolvency Examination

Monday 1 November 2010

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.

Note: References to legislation are to that which was in force on 30 April 2010. 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.

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1. Helena and Bertram are the only shareholders and directors of Awful Ltd ("the Company") which manufactures and sells air brake systems for commercial vehicles.

During the past year sales have declined dramatically because of the insolvency of a major customer and the general decline in demand for new commercial lorries.

The monthly wages, which were due last Friday, were not paid and the Company ceased to trade. The directors have asked you to take a look at the Company's financial position as a matter of urgency. You ascertain that the books and records are up to date and that the Company's financial accountant has prepared the following accounts to 31 October 2010:

Ref to notes		**£'000**	**£'000**	**£'000**
	Fixed assets			
1	Land & buildings		2,000	
2	Plant, machinery & equipment		3,400	
3	Motor vehicles		100	
4	Investment in subsidiary		300	5,800
	Current assets			
5	Inventories – raw materials	2,200		
	Inventories – work in progress	100		
	Inventories – finished goods and goods for resale	800	3,100	
6	Receivables		4,800	
	Deferred tax		400	
	Cash at bank and in hand		200	
				8,500
	Creditors: amounts falling due within one year			
7	Trade creditors		(8,000)	
8	Bank overdraft		(2,500)	
9	Hire purchase and finance leases		(500)	
10	Taxation and social security		(400)	
11	Other creditors		(200)	
12	Accruals and deferred income		(400)	(12,000)
	Total assets less current liabilities			2,300
	Creditors: amounts falling due after one year			
9	Hire purchase and finance leases		(900)	
8	Bank loan		(700)	
	Pension deficit		(500)	(2,100)
	Net assets including pension deficit			200
	Called up share capital		100	
	Share premium account		100	
	Revaluation reserve		300	
	Accumulated deficit		(300)	200

Notes

(1) The land and buildings comprise a freehold factory and office complex. They were revalued last year by a local firm of chartered surveyors and are included in the books of account at the revalued amount. Since that time the value of commercial properties in the local area has declined by about 25%.

(2) Plant, machinery and equipment comprises

	£'000
Production line	800
Other machinery and equipment	2,000
Office fixtures & fittings	600
Total	3,400

Last year the Company entered into an asset purchase agreement, with Zog Finance Ltd, to finance the purchase of the production line. The finance company has a fixed charge over the production line which has priority over TownCity Bank's charge. The agent has told you that, as the production line is not attached to the building, there may be several interested purchasers from the Far East. The realisable value is estimated to be 60% of the book value.

In addition, machinery with a net book value of £550,000 is subject to £500,000 of hire purchase charges. The realisable value of the machinery is estimated to be 40% of book value.

Further machinery which was purchased three months ago, for £400,000, is subject to a retention of title claim.

The office fixtures and fittings have a negligible realisable value.

(3) The motor vehicles are subject to hire purchase agreements and comprise two cars used by the directors. The estimated realisable gross value of the cars is £30,000.

(4) The subsidiary was set up two years ago in order to carry out research and development into vehicle braking systems. It relies upon the Company to meet its costs, which are mainly salaries, notional rent for part of the factory premises and some technical equipment. It has negligible other assets.

(5) Inventories are shown in the balance sheet at cost. 80% of the raw materials and 90% each of the work in progress and finished goods are for a specific brake system that is supplied to the insolvent customer. The remainder of the inventories are sold to authorised parts dealers.

(6) Receivables comprise:

	£'000
Trade debtors	3,500
Due from subsidiary	1,100
Prepayments	200
	4,800

Trade debtors include £2,900,000 due from the Administrator of the Company's major customer. A further £400,000 of trade debtors is over six months old and the directors are finding these debts difficult to collect.

(7) There are over 2,500 trade creditors. They include a German company which invoiced €50,000 in September when the exchange rate was £1 = €0.90. On Friday the exchange rate was £1 = €0.80.

(8) The overdraft and term loan from TownCity Bank is secured by a fixed and floating charge created in July 2005.

(9) Hire purchase and finance leases comprise finance in respect of the following assets:

	£'000
Production line	800
Motor vehicles	100
Other machinery and equipment	500
	1,400

(10) Taxation and social security comprise £150,000 in respect of VAT, which is two months in arrears and £250,000 in respect of PAYE and NI, which is three months in arrears.

(11) Other creditors include arrears of wages of £180,000, accrued during the last month and not exceeding £800 per worker. (You may ignore other employee liabilities).

(12) Accruals and deferred income includes £200,000 for warranty claims. The Company provides a one year warranty on all of the goods it sells. (You ascertain that the returns under warranty in the three months up to 31 October 2010 represented sales of £500,000.)

Requirements

Using the information provided in the draft balance sheet and associated notes, and stating any assumptions:

(a) prepare a statement of affairs for the Company as at 31 October 2010, making and explaining estimates of any contingent or prospective liability at a level that you regard as commercially realistic. (12 marks)

(b) prepare a deficiency account for the Company as at 31 October 2010. (5 marks)

(c) suggest, with reasons, what options are available to the Company. (3 marks)

(20 marks)

2. Locke Ltd ("the Company") operates six successful pharmacies in West Yorkshire. The five directors and four shareholders wish to retire. The four retiring shareholders have received tax advice recommending that a Members' Voluntary Liquidation of the Company would be a tax efficient means of releasing their capital. All of the shareholders wish you to proceed with a Members' Voluntary Liquidation as soon as possible.

The shares are held as follows:

	5% Cumulative Preference Shares of £1	**Ordinary £1 Shares**
Mr Kant	200,000	100
Mrs Kant	100,000	100
Mr Hume	200,000	100
Mrs Hume	100,000	100
Mr Mill	Nil	Nil

You have the following information.

(1) There is no floating charge.

(2) Mr Mill is a pharmacist. He is an employee as well as a director and holds no shares. He intends to retire when the Company ceases to trade.

(3) Mr & Mrs Kant are on a world cruise celebrating their wedding anniversary and want funds remitted to them as soon as possible.

(4) Another pharmacy business has offered £3 million for the Company's assets and undertaking but excluding:

- the liabilities;
- a leasehold premises, located in Wakefield ("the Wakefield premises");
- the directors' current accounts;
- the directors' cars.

Solicitors are drawing up the sale contract which is due to be completed in the next few days.

(5) The liabilities in the accounts are:

Liabilities	**£'000**
Trade payables	200
Other current provisions	30
Corporation tax	50

(6) The balances on the directors' loan accounts are:

	Receivable from Company £'000	**Payable to Company £'000**
Mr Kant	-	20
Mrs Kant	-	10
Mr Hume	-	30
Mrs Hume	10	-
Mr Mill	-	-

The balance on Mrs Hume's account of £10,000 is in respect of directors' fees. Mrs Kant owes the Company £10,000 for cosmetics and other goods purchased from the pharmacies. Mr Kant's and Mr Hume's balances represent excess fees drawn over the past year.

(7) There is no value in the Wakefield premises. The lease ends on 23 June 2011. The annual rent is £100,000 payable quarterly in advance on 25 December, 25 March, 24 June and 29 September and it is unlikely that it will be re-let.

(8) The annual dividend on the preference shares was due on 30 September 2010 but has not yet been paid.

(9) All of the directors wish to keep their Company cars. The resale value of the cars is:

	£'000
Mr Kant	40
Mrs Kant	20
Mr Hume	50
Mrs Hume	10
Mr Mill	10

Requirements

(a) Set out the steps that you should advise directors and members to take to procure a Statutory Declaration of Solvency and a members' resolution for placing a company into Members' Voluntary Liquidation. (7 marks)

(b) Set out the problems of an early distribution to members in a Members' Voluntary Liquidation. (3 marks)

(c) Assuming that this Company enters Members' Voluntary Liquidation set out the issues that the Liquidator will need to settle before making a distribution to members. (5 marks)

(d) Set out the amounts that should be paid to each of the members, distinguishing the types of payment. (5 marks)

(20 marks)

3. Hankie Plc ("the Company") entered into Creditors' Voluntary Liquidation on 29 October 2010, following meetings of members and creditors on the same day. You attended the creditors' meeting on behalf of a major creditor and were appointed Liquidator, overturning the members' nomination.

You have spent the weekend looking into the circumstances of the Company's Liquidation and ascertain that the Company operated two autonomous branches, Cough and Sneeze, which operated from premises in London and Newcastle respectively:

- Cough is relatively profitable and the directors have indicated that they wish to purchase the assets of this branch and to retain 15 of the 30 employees employed at this branch. You hope to maintain production at Cough until the end of the week, on 5 November 2010, to allow two of its directors, Archie and Ben, to finalise their offer and also to establish whether you can attract any other offers. The Liquidation Committee has given you sanction to continue to trade at Cough.

- You consider that you need to retain 9 employees to maintain production at Cough until the end of the week.

- At the date of Liquidation, 40 people were employed at Sneeze which should be closed down today, 1 November 2010.

- The employees at both branches have not been paid since 1 October 2010.

- On 25 October 2010, the Company made 20 people redundant, 10 from Cough and 10 from Sneeze. They have not been paid since 1 October 2010 and have received no other payments in respect of their redundancy.

- Much of the workforce are on low wages.

- The Company's annual salary review and holiday year is on 1 October 2010.

- The Company has three directors, Archie, Ben and Deidre, and each holds one third of the shares in the Company. They also have not been paid since 1 October 2010. You do not wish to retain them as employees after today.

Requirements

Set out:

(a) the issues that the Liquidator should address with respect to the employees and the types of employee related claims and expenses that will arise in the Liquidation. (20 marks)

(b) what points the Liquidator should include in the letter dismissing employees. (6 marks)

(c) with reasons, what employee related issues that may affect the sale price of the business. (4 marks)

(30 marks)

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PLEASE TURN OVER

4a. Boil Ltd ("the Company") supplies and fits home insulation. It was formed in October 2008 from a business that was originally a partnership of Alistair, Gordon and David who are its three directors and shareholders. The three directors do all of the insulation work and David's wife, Yvette, helps out with the administration. There are no other employees.

The Company occasionally arranged finance, through Risky Finance Plc, for customers to fund the purchase of the insulation and has an appropriate consumer credit licence for this purpose. Risky Finance Plc also assists the Company to fund its stock purchases and the balance on this account is £514,000, unsecured.

You have been contacted by Risky Finance Plc, which is concerned that it is providing finance for stock that has not been purchased and to fictitious customers of the Company. It believes that the Company has at least £300,000 in a bank account, as it had just advanced this amount, but it is concerned that the directors may withdraw it. It has heard that Alistair has left the country and that some of the accounting records are missing.

Requirements

State the options that are available to Risky Finance Plc and state, with reasons, what immediate action(s) you recommend. (6 marks)

4b. You were appointed Liquidator of Depressed Ltd ("the Company") by the Secretary of State on 29 October 2010, following a winding up petition on 15 October 2010. The Company has two properties:

	Warehouse and offices	**Factory and outside storage area**
Tenure	Long lease	Freehold
Rent payable quarterly in advance on the quarter dates	£30,000	-
Rent arrears due at date of Liquidation	£20,000	-
Annual business rates	£48,000	£6,000
Valuation	£100,000	£142,000

You ascertain that:

- About 10% of the floor space of the warehouse contains stock which is valued at £123,000 which your agent advises you will take about one month to sell. It is not feasible to move the stock. The remainder of the warehouse is empty.
- Adjacent to the warehouse are offices which are used by the Company for its administration. There are two rooms that are sub-let to Turndown Ltd, an unrelated company, which owes the Company rent of £3,000 for the quarter beginning 29 September 2010.
- The Company has recently obtained a valuation of £100,000 for the leasehold interest in the warehouse and offices.
- The factory is in a state of disrepair and is empty. The Company had also recently arranged for a valuation and this stated that the value of £142,000 depended upon the site being

developed which, in the valuer's opinion, was likely as the land is next to a canal where there are several properties which have been converted into luxury flats. You have just received a letter from the local Council requiring you to remove some chemical waste which is on the Company's land outside the factory and which is unstable and inflammable. The valuer's report did not mention any chemical waste. The cost of removing the waste is £137,000.

- There are no charges attached to either of the properties.
- You have not yet inspected any documents relating to the properties.

Requirements

(i) If a Liquidator is appointed to a company subject to a winding up order, set out the Liquidator's reporting requirements in relation to the company and the directors. (3 marks)

(ii) Set out the issues that the Liquidator has to consider in relation to each of the properties and set out the steps that you recommend the Liquidator should take to preserve the value of the estate for the creditors. (21 marks)

(30 marks)