

JOINT INSOLVENCY EXAMINATION BOARD

*Joint
Insolvency
Examination
Board*

Joint Insolvency Examination

Monday 2 November 2015

LIQUIDATIONS

(3.5 hours)

ANSWER ALL FOUR QUESTIONS

EACH QUESTION CARRIES TWENTY-FIVE MARKS

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 2015. 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 Act 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. Alf operated as a sole trader in the building trade until 2005 when, following the advice of his accountants, the business was incorporated as Alf Limited (“the Company”) with Alf as the sole shareholder and director. The Company operated from a workshop, with attached office and building yard. In 2010, the Company set up a branch, Alf’s Kitchens (“AK”), designing and installing bespoke kitchens and operating from separate premises from the building operation.

The Company built house extensions as well as purchasing and refurbishing properties for sale. It also acquired several freehold commercial and residential properties for the purpose of investment and gaining rental income; these properties were mainly financed by Z Finances Plc which took fixed and floating charges by way of security. In November 2014, Z Finances Plc repossessed all but one of the investment properties and its indebtedness was fully repaid in May 2015.

During 2014 and early 2015 the Company suffered a decline in demand for its building services.

The Company went into Liquidation on 18 September 2015, following a petition dated 15 July 2015. You were appointed Liquidator on 28 October 2015 by the Secretary of State pursuant to Section 137(3).

Since your appointment you have identified the following issues:

- i. The Company operated one bank current account with Village Bank Plc. The Company had been at, or over, its overdraft limit of £40,000 for the six months prior to the date of the winding up order. Village Bank Plc does not hold any security.
- ii. Alf asserts that he was unaware of the winding up petition. He said that he was busy trying to find building work.
- iii. The freehold investment property is a shop with a flat above. There is one lease for the entire property which has 20 years remaining. The rent is £5,000 per quarter payable in advance on the usual quarter days. Rent has not been received for the last two quarter days.

The flat is sub-let by the lessee for £400 per month. Your agent has estimated that the whole property has a value of £150,000 with vacant possession.

- iv. The Company occupies the building division’s workshop, office and yard under a lease created in 2005 and which has 15 years remaining. The rent is £10,000 plus VAT per quarter payable in advance on the usual quarter days. The rent, which includes buildings insurance of £200, has not been paid for the last two quarter days. On 14 July 2015, an Enforcement Agent entered the premises on behalf of the landlord and entered into a Controlled Goods Agreement (“CGA”). The following assets are included in the CGA:

	Book value
	£
Tools	2,000
Fixtures and fittings	1,500
Stocks	500
Van	1,800

The Enforcement Agent returned to the premises on 15 July 2015 to include in the CGA the van, which he had omitted the previous day. All of the assets subject to the CGA were in the building and yard except for the van which was parked in the road immediately outside the workshop. In lengthy correspondence with the Enforcement Agent Alf argued that the building tools that were seized belong to him personally, and that he would be unable to work without them. This correspondence appears to have delayed the Enforcement Agent from taking any further action in respect of the CGA.

- v. AK operated from leasehold premises, comprising an office/showroom with a workshop attached. The lease, which was created in 2010, has 15 years remaining. Rent of £100,000 per annum is payable in advance on the quarter days. The rent has not been paid for the previous two quarters. Business rates, of £24,000, have not been paid for the current year. On 17 September 2015, the landlord changed the locks on AK's premises.
- vi. AK continued trading until 18 September 2015, at which date it had three outstanding orders from customers. AK's terms of trade provided for customers to pay a 10% deposit on placing their order with the balance payable in full two weeks before fitting. The amounts paid into the Company's bank current account in respect of the three outstanding orders were:

	Date of order	Deposit Paid	Final Payment Received
		£	£
1	1 July 2015	3,000	27,000
2	21 July 2015	4,000	0
3	5 September 2015	6,000	0

None of these kitchens have been fitted. Orders 1 and 2's kitchen units are located in AK's workshop. The kitchen units for Order 3 are in transit from Poland from the supplier who has not been paid.

Requirements

Write a file note explaining your strategy for dealing with the issues that you have identified. Stating your reasons and any assumptions made, set out the steps that should be taken by you, as Liquidator, to resolve each issue.

(25 marks)

- 2a. Unhappy Leisure Centre Limited (“the Company”), which owns and runs 2 leisure centres, is a company limited by guarantee with each member’s guarantee being limited to £50. There are currently 20 members comprising managers and senior staff at the centres.

The Company was formed in 2006 to provide leisure facilities mainly for Rainy Metropolitan Borough Council (“Rainy MBC”). One half of the Company’s income has come from a contract with Rainy MBC which in the past has been renewed on an annual basis. However, because of cutbacks in Council spending, the contract came to an end on 30 September 2015.

Members of the public pay an entrance fee when they use the leisure facilities. The contract with Rainy MBC provided for the free provision of services for some users including schoolchildren and those aged 60 or over. Frequent users may become “Gym Members” paying an annual fee either in twelve monthly instalments or, for a small discount, in one lump sum in advance.

The Company’s balance sheet at 30 October 2015 is:

	Ref	£’000	£’000
Fixed Assets			
Freehold land and buildings	1	4,000	
Plant and equipment	2	2,000	
Furniture and fittings		600	6,600
Current Assets			
Stock	3	100	
Debtors	4	600	
Cash at bank and in hand		200	<u>900</u>
			7,500
Liabilities			
Amounts falling due in less than one year			
- bank loans	5	(400)	
- finance leases	6	(100)	
- trade creditors	7	(1,800)	
- tax and social security	8	(20)	
- other creditors	9	(130)	
- accruals and deferred income	10	(1,500)	<u>(3,950)</u>
Total assets less current liabilities			<u>3,550</u>
Amounts falling due after more than one year			
- bank loans	5	(2,000)	
- finance leases	6	(300)	
- deferred tax	11	(100)	(2,400)
Total assets less liabilities			<u><u>1,150</u></u>
Represented by			
Revaluation Reserve	1	900	
Restricted Funds	12	100	
Unrestricted Funds		150	<u>1,150</u>

Notes to the balance sheet

Ref

1	Freehold Land and Buildings	The leisure centres were revalued in 2008. Since that time property values in the leisure industry have declined by about 25%.	
2	Plant and equipment	75% of the book value comprises equipment (including gym equipment with a book value of £400,000) which may achieve 50% of its book value at auction. The remainder of the plant and equipment has negligible realisable value.	
3	Stock	Stock comprises £85,000 work in progress for the construction of an indoor tennis facility and £15,000 goods for sale in the centres' shops. The latter includes £10,000 of swimwear supplied by Swimalot Plc. Swimalot Plc has written to the Company demanding the return of its goods under a retention of title clause.	
4	Debtors	Debtors comprise:	£'000
		Trade debtors	300
		Other debtors and prepayments	100
		Rainy MBC	<u>200</u>
		Total	<u>600</u>
		Other debtors and prepayments comprise £100,000 paid to a firm of architects on account of providing a design for an extension to one of the leisure centres. The design has not yet been received.	
		The amount due from Rainy MBC is in respect of the previous year's contract.	
5	Bank loans and overdraft	In 2006, the Company granted to Village Bank Plc a fixed and floating charge over all of its assets and undertaking.	
6	Finance leases	Finance leases represent amounts due to AssetFinance Plc secured on the gym equipment in the leisure centres. The security has priority over Village Bank Plc's floating charge.	
7	Trade creditors	Most of the 250 trade creditors are over 90 days old. Several are pressing for payment.	
		Included in trade creditors is £30,000 due to Swimalot Plc.	
8	Tax and social security	Tax and social security represents the amount due to HMRC in respect of PAYE and National Insurance for the full and part-time employees.	
9	Other creditors	Other creditors comprise:	
		(i) Gross wages	£8,000
		(ii) Fees due to independent sports instructors	£10,000
		(iii) Rainy MBC for arrears of business rates	£112,000
		There are 50 full and part time weekly paid employees, earning between £200 and £400 per week.	
		There is a high turnover of weekly paid staff and all of the current employees commenced their employment after July 2013. The directors have calculated that holiday pay of £12,000 is outstanding.	
		The 20 monthly paid employees were paid on 29 October 2015.	

Certain independent sports instructors are contracted to teach sports including swimming, football and gymnastics. Pupils pay the Company, usually in cash, for the instruction before each lesson on entry into the relevant leisure centre. The Company pays the instruction fees to the instructors each week.

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|----|------------------------------|---|
| 10 | Accruals and deferred income | Accruals represent £200,000 in respect of roof repairs carried out to one of the leisure centres. The works have not yet been completed or invoiced. |
| | | Deferred income of £1,300,000 represents advanced membership fees received for use of the leisure facilities. These are transferred to the income and expenditure account on a monthly basis. |
| 11 | Deferred tax | Deferred tax arises from capital allowances in excess of depreciation and other timing differences. |
| 12 | Restricted funds | These represent a charitable donation made to finance the building of a climbing wall in one of the leisure centres. |

Requirements

- (a) Prepare a Statement of Affairs for the Company as at 30 October 2015; (16 marks);
- (b) Prepare a deficiency account for the Company as at 30 October 2015 (4 marks);

Clearly state any reasonable assumptions which you have made.

NOTE: Ignore VAT

2b. Requirement

Set out, by reference to the tests laid down in the Act and to relevant case law, how you would assess whether or not a limited company is able to pay its debts. (5 marks)

(25 marks)

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3. You are a manager in a firm of Authorised Insolvency Practitioners.

Your Aunt has referred her best friend, Daisy, to you for professional advice. Daisy is a designated member of a law firm ("the LLP") which has had cash flow problems for some time. Altogether, the LLP has three members, all of whom are designated members, and who, with the 15 members of staff, specialise in family law and property conveyancing. Your cousin is a junior employee of the LLP.

The Solicitors' Regulation Authority intervened in the LLP's practice and took away its clients' files on 23 October 2015.

At 23 October 2015 the LLP's assets and liabilities were:

Assets	£
Amounts recoverable on contracts	100,000
Amounts due from members	190,000
Other debtors and prepayments	60,000
Cash at bank and in hand	10,000
Liabilities	£
Anytown Bank Plc - loan	(70,000)
Preferential creditors	(20,000)
Other creditors and accruals	(900,000)

You have ascertained the following:

- i. Amounts recoverable under contracts represent an estimate of monies due for on-going client work (work in progress). It is unlikely that anything will be recovered as none of the work has been completed by the LLP;
- ii. Amounts due from members comprises two elements. The first is £60,000 due from each member in respect of drawings taken before profit was earned. The second is a debt due from Daisy following the purchase in April 2015 by her of a car for £10,000 from the LLP. The car was purchased by the LLP in March 2015 for £50,000.
- iii. Other debtors and prepayments comprise:

	£
<i>Sundry debtors</i>	
Tulip	30,000
Dahlia	25,000
<i>Prepayments</i>	
Rose Utilities Co	3,000
Crocus Phone Co	2,000
	<u>60,000</u>

Tulip operates as a sole trader, Tulip Office Supplies. She intends to enter into an Individual Voluntary Arrangement proposing a 50% dividend to creditors over three years. A creditors meeting to consider her proposal will be held on 6 November 2015. Tulip is also included in the list of the LLP's creditors for £25,000 in respect of office services provided to the LLP;

Dahlia, who trades as Dahlia Office Fitters, assisted in the renovation of the LLP's offices in 2014. After a lengthy dispute over the quality of the work, Dahlia agreed to reimburse £25,000. Dahlia was made bankrupt last week;

- iv. The LLP has commenced proceedings against IT Limited, which supplied computer software support to the LLP. It failed to provide an adequate level of support and Daisy considers that, after costs, £30,000 is recoverable. IT Limited is not included in the debtors' ledger;

- v. The LLP granted a floating charge over its assets and undertaking to Anytown Bank in January 2010. The three members have given personal guarantees to the Bank;
- vi. There are over 150 creditors, most of which are over 90 days old. Not all of the creditors' addresses are recorded in the creditors' ledger;
- vii. The creditors include, Brudt A/S, a Danish registered company, that is owed DKrone 400,000 (included in the creditors' list at £39,000) and Casse SA that is owed Euro 16,000 (included in the creditors' list at £11,000);
- viii. Daisy showed you a letter from Mrs Greenfingers, a former client of the LLP. It appears that Mrs Greenfingers fell down the stairs in the LLP's offices in July 2015, breaking a leg. She intends to submit a claim for £1 million for pain and suffering as well as for loss of earnings;
- ix. The LLP's premises are occupied under a 10 year lease, which started in 2008. The current rent is £10,000 per quarter payable in advance on the usual quarter days. The September rent has not been paid and is included in other creditors and accruals in the accounts. The freehold of the premises is owned jointly by the three members;
- x. Bluebell, a creditor, has telephoned you to say that she delivered furniture and fittings, which were ordered and paid for by the LLP, to Daisy's home. She also believed that the members had misappropriated funds although she was unable or unwilling to say how.

Requirements

- (a) Set out the issues you should consider when deciding whether or not to provide advice to the LLP (6 marks);**
- (b) Set out the practical and legal steps required to place the LLP into Creditors' Voluntary Liquidation (5 marks);**
- (c) Write a file note of the practical and legal steps that would need to be taken in the Liquidation to resolve the specific matters of which you are currently aware. (14 marks)**

(25 marks)

4. Elogen Limited (“the Company”) went into Creditors’ Voluntary Liquidation on 29 September 2015 and you were appointed Liquidator following meetings of members and creditors held on that date.

You have the following information about the Company:

- i. The Company had been in a three year Company Voluntary Arrangement that concluded in January 2014.
- ii. The Company supplied specialist dry food ingredients to manufacturers of ready meals. It sourced the ingredients from the UK and abroad and sold them onto food manufacturers in the UK. Its turnover had been declining for several years, partly because it could not compete on price with a French rival and partly because the reliability of its deliveries was poor. It ceased to trade at the beginning of September 2015 as it had been unable to pay the August wages.
- iii. In the five years to the date of Liquidation there had been four directors

Director	Date of appointment	Date of resignation	Shareholding (£1 shares)
Betty Bones (“Betty”)	1 July 2010	n/a	100
Catty Limited (“Catty”)	1 July 2010	n/a	100
Deidre Bones (“Deidre”)	15 August 2011	14 August 2014	100
Ethel Smith (“Ethel”)	1 July 2010	2 September 2015	0

Catty is a Jersey registered Company that is wholly owned by Arthur Bones (“Arthur”). Arthur, who is Betty’s husband, represented Catty at the Company’s Board meetings. Deidre is Arthur and Betty’s daughter: her parents made her a director and shareholder of the Company on her 21st birthday. Ethel was the Company’s financial accountant.

The directors have not been particularly helpful to you, being evasive when answering questions. The Company’s auditor, Blowmedown Partnership, has also declined to assist you, giving as its reason the fact that it also acts for Arthur and all of his other business interests.

- iv. The Company’s head office was in London and it traded from two warehouses, in Essex and Yorkshire. It shared its head office with Arthur’s companies, including Catty. All of the premises are owned by Catty. Arthur took a strong interest in the Company, often taking decisions in Betty’s absence.
- v. Until December 2014, the Company occupied a third warehouse in Surrey on which it held the lease. With the decline in business, the Company ceased operating from Surrey and the lease (which had 15 years to run) was transferred to Catty for £30,000. The Company had paid a premium of £900,000 for the lease in 2010.
- vi. A review of the Company’s bank account indicates that £200,000 was paid to Catty in the 9 months prior to Liquidation and £500,000 in each of the years 2010 to 2014.
- vii. The Company, which has an accounting date of 31 December, declared and paid a dividend of £1 million in each of the financial years 2013 and 2014.

viii. The Company's Statement of Affairs as at the date of Liquidation showed:

Description	£	Notes
Fixtures and fittings	18,000	Head office desks and chairs
Stock	112,000	A stock count has revealed that stock of £12,000 is held at the warehouse in Essex. Of the remaining £100,000, 50% seems to be held by Slow Freight Forwarders Inc. If this stock is not delivered within the next few days it will have passed its use by date and have no value. It is unclear whether the remaining 50% exists, but a creditor has suggested that it may be held by Catty in the Yorkshire warehouse, as similar stocks are held there, along with the relevant documents.
Debtors	85,000	Debtors include a loan of £50,000 to Deidre, apparently to fund her education. Deidre had not taken any interest in the Company and had resigned as a director in August 2014, before taking an extended holiday in Australia.
Preferential creditors (employees)	100,000	The preferential creditors include £40,000 due to Betty as she had not drawn any salary in the four months leading to the Liquidation.
Unsecured creditors	4,000,000	Unsecured creditors include £300,000 due to Catty in respect of fees for services rendered and rent on the three premises used by the Company. In April 2015, the Company contracted to purchase a new air conditioning unit for the Essex warehouse. This was fitted in June 2015. The total cost of £250,000 is included in unsecured creditors.

- ix. Stock was purchased from the relevant supplier when a sales order was received. The accounting records reveal that some purchases were made through Catty or, sometimes, direct from Arthur. The goods purchased from Arthur were on average 15% more expensive than those bought directly from suppliers, although the price charged to customers did not reflect this.
- x. The Company had two overdrawn bank accounts with two different banks. Both accounts have been overdrawn for the past two years. Neither of these accounts reconciled with the Company's cash book at the date of Liquidation, with significant amounts of cash being unaccounted for. It seemed that Arthur frequently moved funds between the Company's accounts and accounts at Catty and his other companies. The purpose of these movements is unclear and Arthur has been evasive when questioned about them.
- xi. The Company has not granted any fixed or floating charges.

Requirements

Set out the steps that you, as Liquidator, should take to seek to address the matters so far identified by you. Give reasons for your proposed courses of action and make reference to relevant legislation and case law.

(25 marks)

