JOINT INSOLVENCY EXAMINATION BOARD

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Pilot paper for the 2018 exams

CORPORATE INSOLVENCY (3.5 hours)

ANSWER ALL FOUR QUESTIONS

QUESTIONS 1,2 AND 3 CARRY 20 MARKS EACH AND QUESTION 4 CARRIES 40 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.

Notes:

1. Bammer Limited ("the Company") was formed in 1979 by Mrs Austin and it traded successfully until her retirement in 2014. Whilst Mrs Austin remained the sole Shareholder and a Director of the Company, at this point she appointed her son Robert Austin as Managing Director in her place.

Following his appointment Robert embarked on an ambitious plan to grow the business, taking on larger premises, more machinery and recruiting additional staff. Mrs Austin, impressed by this strategy, resigned as a Director and left the running of the Company to Robert.

Prompted to make enquiries by the Company being unable to pay her monthly dividend, Mrs Austin has discovered that it is in severe financial difficulty. As a consequence, and on a recommendation from the Company's Accountants, she and Robert met you, an Authorised Insolvency Practitioner, to discuss the situation. The notes from this meeting include the following information:

- Mrs Austin thinks that the Company's issues stem from mismanagement by her son and therefore it is her intention to work in the business again as Managing Director.

- The summarised management accounts as at 30 September 2018 are as follows:

Profit and loss account

	12 months to Dec 17	9 months to Sept 18
	£'000	**£'000**
Turnover	8,750	6,300
Cost of sales	(6,550)	(5,040)
Gross profit	2,200	1,260
Overheads		
Rent	300	225
Heat light and power	100	75
Motor expenses	100	120
Wages and salaries	1,500	1,350
Other costs	110	130
Depreciation	250	240
Total overheads	2,360	2,140
Loss before interest and taxation	(160)	(880)
Interest payable	(140)	(110)
Taxation	-	-
Net loss	(300)	(990)

Balance Sheet

	Dec 17	Sep 18
	£'000	**£'000**
Tangible fixed assets	1,300	1,010
Current assets		
Stock	2,000	2,200
Debtors	2,200	1,600
Other debtors	50	25
	4,250	3,825
Creditors due in less than 1 year		
Trade creditors	1,500	2,100
HMRC	100	400
Invoice Discounter	1,760	1,280
Director loan	150	50
Hire purchase	200	200
Other creditors	100	345
	3,810	4,375
Net current assets/ (liabilities)	440	(550)
Creditors due in more than 1 year		
Hire purchase	(1,000)	(800)
Net assets	740	(340)

- Up to and including September 2018 Mrs Austin continued to be paid dividends of £10,000 per month. In the future she intends to take a salary of £100,000 per annum rather than receive dividends.

- The Company pays Robert a gross salary of £25,000 per month.

- The Company's tangible fixed assets are all subject to hire purchase agreements with Bartoli Finance Limited. There are 5 years remaining on these agreements and the book value of the relevant assets included in the accounts is considered by Mrs Austin to be an accurate reflection of their realisable value.

- The Company has an invoice finance facility with Stubbs Commercial Finance Limited ("Stubbs"). This facility is supported by an assignment of the Company's trade debts to Stubbs and is normally fully utilised. The Company has experienced no bad debts or problems obtaining payment from customers. Stubbs also has a debenture registered against the Company dated 12 July 2001.

- Included within depreciation for the 9 month period is a £50,000 loss on disposal of fixed assets. The whole of this loss relates to Robert's unencumbered company car that he transferred into his personal name on 1 January 2018.

- The value of the stock held by the Company is overstated as the majority of it is old and redundant. Mrs Austin estimates that its realisable value were it to be sold in the open market is approximately 25% of book value.

Mrs Austin has researched her options and wishes to put forward a CVA to creditors. She is confident that by the time a CVA is approved the following changes can be made to the business:

- The following members of staff can be made redundant immediately without notice;

Role	**Age**	**Years' service**	**Salary £**
Sales Manager	36	2	150,000
Sales Co-ordinator	32	1	95,000
Quality Control Manager	40	3	80,000
Marketing Manager	55	4	75,000

- Robert will take a 25% pay cut as a result of his demotion to Vice Managing Director.

- The 45 remaining staff (excluding Robert and Mrs Austin) will accept a 10% pay reduction.

- Mrs Austin has concluded that Robert is a poor negotiator and, through an improved purchasing process, she is confident that the gross profit margin can immediately be increased to 30%.

- Motor expenses can be halved.

- A detailed examination of utility costs has identified that it would be possible to save 20% p.a. through changes of suppliers.

- The landlord can be persuaded to agree to a rent reduction of 25%.

- Included within other costs for the 9 month period is the full annual contract hire payment of £30,000 for a specialised printer that is no longer required. Mrs Austin would like to return this item but there are 3 remaining annual payments on the rental agreement.
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The revenue of the business is not seasonal and Mrs Austin is confident that the recent level of turnover will continue for the foreseeable future.

Requirements

(a) Based on the information provided, set out the level of monthly contributions to a CVA you would consider appropriate to be put forward to creditors. (5 marks)

(b) Stating appropriate assumptions, prepare a Comparative Estimated Outcome Statement for inclusion in a CVA proposal. (15 marks)

Total: (20 marks)

Note: Ignore Employers' National Insurance

2. Blake and Miranda are the directors and shareholders of Hornbeam Sawmill Ltd ("the Company") which has ceased trading. Blake owns 60% and Miranda 40% of the Company's shares. They are in the process of emigrating and would like to realise their investment in the Company. They have asked you, an Authorised Insolvency Practitioner, to meet them tomorrow.

You have been given the following information about the Company:

Hornbeam Sawmill Ltd
Balance Sheet as at 31 October 2016

	Note	£'000	£'000
Fixed assets			
Land and buildings	1	355	
Fixture and fittings	2	30	
Plant and machinery	3	200	
Intangible assets	4	20	605
Current assets			
Stock	2	50	
Work in progress	5	75	
Trade debtors	6	200	
Other debtors	6	40	
Cash at bank and in hand		15	
		380	
Current liabilities			
Trade creditors		(58)	
Hire Purchase creditor		(10)	
Other taxes and social security	7	(25)	
Directors' loans	8	(79)	
		(172)	
Net current assets			208
Bank overdraft	9		(50)
Net assets			763
Capital and reserves			
Called up ordinary share capital			200
Share premium account			75
Profit and loss account			403
Revaluation reserve			85
Equity shareholders' funds			763

Notes

1. Land and buildings consist of the following:

Sawmill and offices	£270,000
Manager's cottage	£ 85,000

The properties were last revalued for accounts purposes 5 years ago, and a recent valuation has valued the sawmill and offices at £335,000 and the manager's cottage at £115,000. It has been agreed that Miranda can have the manager's cottage at market value as a distribution in specie.

2. It is the intention of the directors to sell the fixtures and fittings and stock at a general auction. The auctioneer has estimated the net proceeds will be:

Fixtures and fittings	£9,000
Stock	90% of book value

3. The plant and machinery includes £15,000 of hire purchase ("HP") assets. The HP company is due £10,000. The Company has a buyer lined up for the HP assets who has agreed to pay book value and the HP company has consented to the sale.

   All the rest of the plant and machinery will be sold in a specialist auction and has generated great interest in the trade due to the high quality and excellent condition of the machines. The auctioneer is confident she will be able to achieve a premium over and above the book value, and has suggested a reserve of £280,000. The auctioneer charges commission and selling costs of 10%.

4. Blake holds a registered patent for a full-sized portable sawmill he designed whilst working at the Company. Blake believes the patent may be of interest to a Canadian competitor and is worth around £25,000.

5. The work in progress relates to an incomplete order for a customer who has gone into liquidation. The directors consider that, if sold to a fencing supplier, they could get £35,000 for the wood.

6. The directors are confident they will achieve an overall 80% recovery of trade and other debtors.

7. Other taxes and social security comprise £15,000 in respect of PAYE and NI for the last two weeks and £10,000 in respect of VAT due since the last VAT return was submitted for period end 30 September 2018.

8. Miranda and Blake have both provided the Company with unsecured loans. Miranda has loaned £50,000 and Blake has loaned the balance.

9. The bank overdraft is secured by a fixed and floating charge over the Company's assets.

10. All wages have been settled by the Company until 31 October 2018 when all staff were made redundant. The ten ex-employees are still owed redundancy pay of £105,500 and employee and employer occupational pension contributions of £14,500 are overdue. All notice and holiday pay has been settled in full.

11. The Company has entered into a supply agreement until 31 December 2018 with a local forestry estate to purchase 1,200 felled trees per annum. By 31 October 2018 the Company had purchased 968 felled trees. The contract states that should the Company fail to purchase the 1,200 trees to which it has committed, it has to pay damages of £125 for each tree it fails to purchase.

12. The Company is party to a Climate Change Agreement for the sawmill facility. Therefore if the Company meets the agreed energy efficiency targets at the end of each annual reporting period, it is eligible for a 35% discount on the Climate Change Levy it pays on gas and 10% discount on electricity. The Company has already received this discount for the year based on estimated consumption, however it did not meet its targets during the last annual reporting period and now needs to report this to HMRC and repay the discount. The Company spent £175,000 on electricity and £50,000 on gas (prior to any discount being applied), in the year to 31 October 2018.

Requirements

In preparation for tomorrow's meeting:

(a) **prepare a statement of affairs for the Company as at 31 October 2018, stating any reasonable assumptions that you make. (11 marks)**

(b) **prepare a distribution statement for each shareholder, stating any reasonable assumptions that you make. (3 marks)**

(c) **write a file note explaining:**

- **(i)** **the purpose of the statement of affairs. (3 marks)**
- **(ii)** **the practical steps a Liquidator should take if Blake and Miranda request an early distribution. (3 marks)**

Total: (20 marks)

Note: Ignore Corporation Tax

3. On 15 October 2018, you were appointed Liquidator of Goingbroke Plc ("the Company") pursuant to Schedule B1, paragraph 83.

Previously, the Company entered into Administration on 2 May 2018, when an Authorised Insolvency Practitioner based in another firm was appointed Administrator pursuant to Schedule B1, paragraph 22. The Company's undertaking and assets were sold by the Administrator on 6 May 2018. The Administrator paid the preferential creditors and the floating charge creditor in full. The floating charge was created on 22 July 2003.

On 15 October 2018, assets comprising cash at bank of £1.5 million and an uncollected debt of £2 million were transferred from the Administration to the Liquidation. The cash at bank is in a deposit account that earns gross interest of approximately £1,000 per month. The Administrator also advised you that unsecured creditors of £10 million had been admitted by him for voting purposes in accordance with Rules 2.38 and 2.39. There was no Creditors' Committee in the Administration.

You wish to declare an interim dividend but you are aware of the following matters:

i. In July 2018 the Credit Controller of Mandible Limited, a creditor for £800,000 (included in the total of those admitted for voting by the Administrator), wrote to the Administrator expressing concern about the conduct of the Administration. The Administrator responded in August 2018 but the Credit Controller was still not satisfied with the conduct of the Administration and especially with the fees charged by the Administrator. The Administrator has not responded to the Credit Controller's latest correspondence. You are aware of several other creditors that have similar concerns.

ii. The Administrator has submitted to you a final invoice for £100,000 in respect of his fees. This invoice, which has not been paid, is in addition to Administrator's fees of £400,000 that have previously been invoiced and drawn during the Administration.

iii. You have not yet drawn any remuneration. The Credit Controller of Mandible Limited has intimated that she is unhappy about yet more fees being incurred.

iv. Sternum Plc provided health and safety advice to the Company and has just submitted an invoice for £200,000, of which £30,000 was incurred during the Administration.

v. Humerus Limited owed the Company £40,000 at the date of Administration. On 12 May 2018 Humerus Limited purchased and was assigned certain book debts of Pelvis Limited (paying 20% of their book value). These debts included a debt of £150,000 incurred by the Company with Pelvis Limited in 2017. The debt to Pelvis Limited was included in the Company's books at the date of Administration.

vi. Ron Dopey, a director of the Company, was owed £175,000 at the date of Administration. This comprises £100,000 in respect of a loan account and £75,000 for the cost of stationery purchased for the Company. These amounts were not included in the total admitted for voting purposes by the Administrator.

vii. The Administrator had considered that only about 10% of the uncollected debt of £2 million was likely to be realisable because the debtor claimed that the work done by the Company was not satisfactory. The Administrator had not made any effort to collect the debt.

viii. In 2008 the Company issued one million 7% cumulative £1 preference shares. The dividend is payable each year in arrears on 30 June and 31 December. At the date of Liquidation, the dividend payable in June 2018 was outstanding. This liability was not included in the total admitted for voting purposes by the Administrator.

ix. One holder of preference shares has written to you claiming that he is owed £200,000, comprising £190,000 lent to the Company in 2016 and £10,000 in respect of his preference dividend. Neither of these amounts was included in the total admitted for voting purposes by the Administrator.

x. At the date of Liquidation, there are ten ordinary shareholders each holding 10,000 £1 shares with 40 pence paid. One ordinary shareholder was listed in the Company's creditors' ledger, at the date of Administration, for £6,000 for services it provided to the Company.

Requirements

Set out how you would address each outstanding matter in order to reach the position where the interim dividend can be declared. Where appropriate calculate the amount which should be accepted by you, as Liquidator, as a claim in the Liquidation or set out the further information you will require in order to calculate that amount. State your reasons and assumptions.

(20 marks)

Note: Ignore VAT

4(a). Lingmoor Furniture Limited ("the Company") is a manufacturer of budget flat pack office furniture which it sells to large distributors as well as direct to small business customers. Following a period of operational difficulties and a large bad debt, in June 2016 you were appointed Supervisor of a CVA.

The approved CVA provided for the Company to pay monthly fixed amounts of £20,000 for a period of 5 years and the Company is currently 2 payments behind. In addition to the monthly contributions, the Company was required to make the following payments to the Supervisor, and until such a time as they were paid the respective assets were to be held on trust for the benefit of creditors;

- repayment of a Director's loan account of £40,000. This has been paid in full; and

- sale of a spare machine valued at £50,000. This was to be sold during the term of the Arrangement but it has not yet been realised.

Under the CVA terms the Supervisor is required to fail the CVA if the monthly contributions fall 3 months behind and such a situation is not rectified within 14 days of issuing a notice of breach. In a recent telephone conversation with the Directors they informed you that, whilst the Company is profitable, its trading performance is significantly worse than forecast. The Directors have decided that they can no longer afford to continue with the CVA and they stated that they wished to appoint you as Administrator to the Company.

Requirements

i) Set out for the Directors how such situations can possibly be resolved without the need for the Company to enter Administration and provide an overview of the process that would typically be followed. (5 marks)

ii) Explain your key ethical considerations as to whether you could accept the appointment as Administrator. (4 marks)

4(b) Yesterday you were appointed Administrator of the Company by order of the High Court. Having reviewed the short-term order book and following discussions with the key customers you have determined that it would be possible to trade the Company in Administration for a 4 week period to provide additional time to sell the business as a going concern. In order to trade profitably during this period you have established that it will be necessary to make 50 of the 195 staff immediately redundant and a further 25 redundant in two weeks' time. These redundancies include office and operational staff, the majority of the latter being union members.

Requirements

Outline your responsibilities to the employees, including both those you intend to make redundant and those you wish to retain. (8 marks)

4(c) Shortly after your appointment as Administrator you received a reservation of title claims from Blencathra Ironmongery Limited ("Blencathra").

Blencathra supplies the Company with packets of fittings (screws, bolts, washers, etc.) required to assemble the furniture. The Company would specify to Blencathra the quantity and type of fittings required for each furniture model and Blencathra would supply the required number of sealed bags containing these items for inclusion in the kits. At the date of your appointment there were 10,000 packets in stock, each marked simply with a code identifying which piece of furniture it was for. In addition there were 6,000 sealed boxes containing complete furniture kits. Blencathra wishes to claim title over all of the packets including those contained in the complete furniture kits.

Requirements

Set out any additional information you would seek from Blencathra. Based on the information provided, summarise the extent to which you think Blencathra will have a valid reservation of title claim and, assuming they do, how you would deal with the situation. (7 marks)

4(d). You successfully sold the Company's trade and assets. The secured creditors have been paid in full and there are sufficient residual funds to enable a large distribution to non-preferential creditors of the Company.

Whilst your actions have resulted in the best return to creditors there is a significant disgruntled creditor; Mott (Sunderland) Limited ("Mott") that represents approximately 55% of the total unsecured debt. Mott had wished to acquire the trade and assets but had been unsuccessful. Mott has stated that it would be their intention to attend all creditors' meetings and vote against all resolutions proposed by the Administrators.

You have decided to convene an initial meeting of creditors and have instructed your case manager to draft the relevant documentation.

Requirements

Outline the steps you would take to handle the situation with Mott in the lead up to the meeting of creditors. (4 marks)

Set out in a note to your case manager the process that you would follow in the event that every resolution proposed at the initial meeting of creditors is rejected. (12 marks)

Total: (40 marks)

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