JOINT INSOLVENCY EXAMINATION BOARD

Joint Insolvency Examination

Tuesday 3 November 2015

ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS (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.

BLANK PAGE

1. Yesterday you, an Authorised Insolvency Practitioner, were appointed Administrator of Aireflow 2000 (Bradford) Limited ("the Company") by order of the High Court.

The Company assembles air filtering systems that are used in the military and healthcare sectors as well as in large commercial building projects. Over the past few years the Company has suffered as a result of government funding cuts together with construction firms moving towards using lower quality and cheaper competitor products. As the Company has taken few steps to reduce its costs it is now loss making.

During the lead up to the Administration you undertook a marketing exercise to explore whether you would be able to sell the business as a going concern. As a result of this work a number of interested parties were identified: however all require a further period to undertake additional due diligence.

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

(a) Given the circumstances, outline your responsibilities to the employees, including both those you intend to make redundant and those you wish to retain. (10 marks)

(b) Using plain English, set out a note for the employees outlining the process for claiming amounts owing to them. Explain how such amounts would be calculated and from whom they would be claimed. (15 marks)

(25 marks)

2. You are a manager in a firm of Insolvency Practitioners. A Partner in your firm will be appointed Administrator of Rivelin Accessories Limited ("the Company"), a retailer of fashion accessories, on 16 November 2015.

The Company was formed in 2004, renting large premises in a top high street location. During the following years the importance of internet shopping was becoming clear and as a result the Company invested heavily in building an online presence and brand. Today the majority of its sales occur via its website.

The emergence of new entrants into the market has resulted in a decline in the Company's margins and lower footfall in its retail premises. As a consequence the Company is loss making as shown in its trading results for the 12 weeks to 31 October 2015:

	Notes	**Online £'000**	**Retail £'000**	**Total £'000**
Sales	a	1,200	360	1,560
Material Cost of Sales	b	(900)	(240)	(1,140)
Distribution costs	c	(120)	-	(120)
Direct staff costs	d	(60)	(30)	(90)
Gross Profit		120	90	210
Direct Operating costs				
Card processing costs		(36)	(4)	(40)
Marketing and advertising	e	(60)	(6)	(66)
Rent and rates		(24)	(72)	(96)
Heat light and power		(12)	(36)	(48)
Storage and warehousing	f	(90)	-	(90)
Divisional contribution		(102)	(28)	(130)
Central costs				
Staff costs	d			(150)
Depreciation				(15)
Interest payable				(45)
Net loss				(340)

You have explored and discounted the possibility of selling the business as a going concern so you are therefore considering the possibility of trading the Company in Administration in order to maximise realisations. You consider it appropriate to trade the business until 20 December 2015 at which point it would be closed and all remaining employees made redundant.

During a meeting with the Directors you made the following notes (as referenced in the accounts above):

a. Sales

The lead up to Christmas is the Company's busiest time of year and under normal circumstances weekly sales increase by 50% compared to the period reported in the accounts opposite.

All of the Company's online sales are paid for by bank card using a system that gives the Company immediate access to the funds (less a processing charge). In the retail outlet 50% of the customers pay by card but as this uses a different system these funds are not available until 2 weeks after the transaction.

b. Stock

The stock is all good quality: however a proportion is likely to be subject to reservation of title claims. A review of relevant supplier documentation and the Company's records has identified that half of the stock will be subject to valid such claims. These items are easily segregated from the remaining owned stock.

You have been approached by a competitor to the Company that has offered to buy any unencumbered stock from you for 60% of the cost price. Your agents have stated that this price would be better than could be achieved elsewhere. The competitor is willing to buy the stock at any stage of the administration process for cash on collection.

The book value of the stock as at 31 October 2015 was £1,300,000 and £300,000 for the online and retail business respectively.

c. Distribution costs

This represents the cost of posting the items sold online and due to lack of credit terms are payable daily.

d. Staff costs

It is envisaged that, due to the expected increase in sales, it will not be possible to make direct staff redundancies until such a time as the Company ceases trade. In relation to the central management team you plan to make 20% of the staff redundant immediately and to spread the remaining redundancies equally over the trading period, dismissing the selected staff at the end of each week. You have agreed that all staff will be paid weekly.

e. Marketing and advertising

The website acquires traffic via search engine marketing and the cost, payable weekly, is directly proportionate to the sales achieved. The cost shown in the accounts includes both these costs (£30,000) and the cost of operating the website itself.

The website is owned and hosted by a third party who is owed £36,000. As the Company had agreed to pay these costs on a weekly basis, the third party is threatening to cease service should the arrears not be paid immediately.

Due to its excellent location the retail unit does not typically pay for advertising spend. The cost incurred during the period represents its sponsorship of the local fashion show.

f. Storage and warehousing

The Company stores its stock for sale through its website in a third party warehouse, the owner of which has agreed for the Company to continue its occupation under the existing arrangements. The cost of these facilities is calculated as 0.5% of the cost price of the stock at the beginning of each week with the charge payable 60 days later.

Requirements

(a) **Stating your reasonable assumptions and showing your calculations, set out a cash flow forecast for a 5 week period from 16 November 2015, including an additional column for any receipts or payments that may occur outside this time. (20 marks)**

(b) **Prepare a file note setting out the key issues that, in these circumstances, you would have to consider before taking the final decision as to whether to trade the Company in Administration. (5 marks)**

(25 marks)

Assumptions:

VAT Rate 20%

3. As a Senior Manager in the firm's insolvency department you attended a meeting yesterday with a Director of Roseberry Steel Limited ("Roseberry"). Roseberry is a profitable and financially strong company and your firm has provided audit services to it for some time. The meeting was prompted by the financial distress of one of Roseberry's customers, Dalby Bins Limited ("Dalby").

Roseberry supplies sheet metal used by Dalby in the manufacture of industrial refuse bins. The two companies have traded with each other for over 10 years and gradually Roseberry has extended its credit terms. This strong relationship has been tested recently as Dalby has not been paying invoices on the due dates and Roseberry is currently owed £950,000.

Roseberry has been contacted by an Insolvency Practitioner advising Dalby. The Insolvency Practitioner has stated that a Notice of Intention to Appoint Administrators to Dalby has been filed in Court and that it is envisaged that an Administrator will be appointed within the next 7 days.

The main purpose of the contact from the Insolvency Practitioner was to discuss whether Roseberry would be willing to continue to supply Dalby during the Administration period and whether it would support a proposal for a CVA put forward by the Administrator following his appointment.

The Director of Roseberry did not react well to the news of the pending insolvency as they had only the day before delivered goods amounting to £200,000 plus VAT.

You have been asked to provide advice to Roseberry in relation to this issue.

Requirements

Set out for Roseberry;

(a) Your recommendations as to what actions it should take in order to minimise its potential loss. (5 marks)

(b) The steps required and information that would have to be provided to Dalby or its Administrator to allow Roseberry to recover goods previously supplied. Include an outline of the potential challenges that Roseberry may face in these circumstances when seeking to recover the stock. (10 marks)

(c) How the provision of future supplies to Dalby in Administration should be structured and matters relating to this that Roseberry should be aware of. (5 marks)

(d) A broad overview as to what a CVA is, its purpose and, considering these circumstances, the key steps to approval. (5 marks)

(25 marks)

4. You are a manager in the insolvency department of a large accountancy practice and recently attended a meeting with three of the Directors of Kinder Industries plc ("the Company").

The Company's financial difficulties have led to its primary funder Bleaklow Commercial Finance Limited ("Bleaklow") introducing to the situation a firm of Insolvency Practitioners. Following a review by the firm of Insolvency Practitioners it appears likely that the Company will be placed into Administration in the near future by the Directors or, if they fail to act, by Bleaklow as a Qualifying Floating Charge holder.

The Directors you met are interested in acquiring the trade and assets of the Company and have requested your assistance in negotiating with the proposed Administrator.

The Directors provided you with the following information during your meeting:

- Whilst the Company is loss making it has a good reputation and brand name within its sector. Abbreviated management accounts for the last 3 months show the following:

	£'000
Turnover	30,000
Material costs	(20,000)
Gross profit	10,000
Overheads	(15,000)
Net loss	(5,000)

- The Directors are confident that they can improve the trading results and achieve a breakeven profit position within the next 3 months. A reduction in staff levels is critical to this plan.

- In order to advise Bleaklow as to their options the Insolvency Practitioners required the Company to instruct a firm of Chartered Surveyors to conduct a valuation of its assets. The Directors have received a copy of this valuation with the following values.

	Note	**Book Value**	**In situ**	**Ex situ - 180 day marketing**	**Ex situ - 90 day marketing**
		£'000	**£'000**	**£'000**	**£'000**
Stock	(i)	5,000	3,000	1,000	500
Plant and Machinery	(ii)	10,000	8,000	6,000	5,000
Office equipment		250	50	25	20
Total		15,250	11,050	7,025	5,520

Notes:

(i) The stock valuations do not take account of potential reservation of title claims. The Directors anticipate that approximately 50% of the stock would have such a claim over it.

(ii) The plant and machinery and office equipment would be required for the business to continue.

- The Company leases its premises and it would not be practical to move. The landlord is owed £400,000 for the quarter commencing 29 September 2015.

- There is a key trade supplier that is owed £500,000. Without ongoing supply from this creditor the Company will not be able to continue to trade.

- The Company's debtor book is subject to an invoice finance facility with Bleaklow. The gross debtor ledger is £20 million and the amount owed to Bleaklow £15 million. The Directors believe that if there is no continuity of supply a large proportion of the customers will refuse to pay their debt.

- The Directors have access to funding from a private equity investor who has committed to a maximum of £10 million to be available immediately.

Following your meeting you discussed the situation with the proposed Administrator who informed you that he was about to commence marketing the business for sale but, as salaries amounting to £4 million are due in 2 weeks, he thought that the prospects of finding an acquirer in such timescales was low. The proposed Administrator had concluded that it was not possible to trade the Company in Administration and therefore any disposal would be in the form of a 'pre-packaged' sale.

Requirements

(a) **Assuming that the sale of the Company's trade and assets will be completed by an Administrator, prepare a note to the Directors outlining the key issues that they will need to consider regarding their proposed acquisition. (15 marks)**

(b) **In these circumstances and bearing in mind what an Administrator may consider acceptable, explain how you would propose the Directors structure an offer to the Administrator for the Company's trade and assets. (10 marks)**

(25 marks)