

13 November 2018

CORPORATE INSOLVENCY (3.5 hours)

This exam consists of **four** questions (100 marks).

Marks breakdown

Question 1	20 marks
Question 2	20 marks
Question 3	20 marks
Question 4	40 marks

1. Please read the instructions on this page carefully before you begin your exam. If you have any questions, raise your hand and speak with the invigilator before you begin.
2. Please alert the invigilator immediately if you encounter any issues during the delivery of the exam. The invigilator cannot advise you on how to use the software. If you believe that your performance has been affected by any issues which occurred, you must request and complete a candidate incident report form at the end of the exam; this form must be submitted as part of any subsequent special consideration application.
3. Click on the **Start Exam** button to begin the exam. The exam timer will begin to count down. A warning is given five minutes before the exam ends. When the exam timer reaches zero, the exam will end. To end the exam early, press the **Finish** button.
4. You may use a pen and paper for draft workings. Any information you write on paper will not be read or marked.
5. The Examiner will take account of the way material is presented. Candidates should answer the questions set: marks will not be awarded for extraneous material.
6. Ensure that all of your responses are visible on screen and are not hidden within cells. Your answers will be presented to the examiner exactly as they appear on screen.
7. References to legislation are to that which was in force on 30 April 2018. References to 'the Act' are to the Insolvency Act 1986 as amended.
8. References to Sections, Schedules and Rules are to Sections and Schedules of the Act and to Rules of the Insolvency (Scotland) Rules 1986.
9. References to Sections and Rules of other Acts, Regulations and Orders will mention the Act, Regulation or Order.

Question 1

You are an Authorised Insolvency Practitioner and have been contacted by the Directors of Dousard Limited ("the Company"), which operates eight fast food restaurants. The Company's cash flow position has deteriorated over the last 12 months following a material increase in business rates and the impact of the national living wage.

The Directors have confirmed that the Company will be unable to pay this month's wage bill and cannot see any opportunity to turn the business around. The Company therefore ceased trading yesterday and the Directors would like to place the Company into Creditors' Voluntary Liquidation.

Requirements

(a) Set out the key practical and legal steps required to place the Company into Creditors' Voluntary Liquidation (12 marks)

Following your appointment as Liquidator to the Company by the shareholders and creditors of the Company, you have the following matters to deal with:

- A creditors committee, comprising four members was formed shortly after your appointment. Three of the members are creditors and one is a contributory. One of the creditor committee members has failed to attend the last three committee meetings.
- You have identified that the Company's shareholders have not paid the full value of their shares. Of the £100,000 total nominal share capital, £80,000 is unpaid. Together the shareholders are due £10,000 of unpaid dividends relating to the financial year ended 31 May 2018.

Requirements

(b) Prepare a file note outlining how you would deal with the above two matters. (8 marks)

Total: (20 marks)

Question 2

You are an Authorised Insolvency Practitioner and have been contacted by Robert and Ned, the Directors of Westerfall Limited (“the Company”).

The Company, which has been struggling for some time, supplied TV show merchandise to high street retailers. Over the last 2 years Robert has lent £275,000 to the Company to support its losses. However, due to the failure of a major customer, Cerslyn Limited (“Cerslyn”), the Company found itself in a critical position and unable to pay outstanding VAT due to HMRC.

The Company is now in compulsory liquidation following a winding up petition presented by HMRC on 11 September 2018 and a winding up order made on the 23 October 2018. The total amount owing to the creditors of the Company is £500,000.

Robert and Ned have requested your advice on the following matters:

- Robert and Ned have set up a new company called Westerfall (2018) Limited and would like to acquire the assets of the Company from the Liquidator so they can continue in business.
- The Company received notification of the appointment of Administrators to Cerslyn in May 2018 and was advised that “dividend prospects for unsecured creditors at this time are unclear, with any dividend likely to be less than 5p/£”. Cerslyn owes the Company £75,000. From May 2018 the Company was unable to pay its trade suppliers and three creditors including HMRC obtained judgement against the Company. The Company ceased trading on 23 October 2018.
- Robert and Ned set up an Employee Benefit Trust six years ago. Money was paid to an offshore trustee from the Company’s profits and the trustee then administered a fund on behalf of Robert and Ned who were the trust’s beneficiaries. The money in the trust was then loaned to Robert and Ned and therefore not subject to income tax. These loans remain outstanding. The Company has received an accelerated payment notice from HMRC requesting payment on account of the tax owed following use of this tax avoidance scheme.
- Robert, in his personal capacity, provided consultancy services to the Company in relation to sourcing new customers and manufacturers, for which he received a 20% commission. He then invoiced the Company on a monthly basis. Over the last twelve months Robert issued valid invoices and received £125,000 from Company funds.
- For the past three years, the university tuition fees and living costs of Arla, Ned’s daughter, have been paid by the Company. These total £55,000. There was never any intention that his daughter would repay these monies to the Company.

Requirements

Write a file note in preparation of your meeting with the Directors, advising them of the key points to consider in relation to the above five matters. (20 marks)

Question 3

You are employed by a firm of Accountants and work for one of the Partners, who is an Authorised Insolvency Practitioner.

You have been approached by Mr and Mrs Gerrard who are equal Shareholders in and Directors of Thorny Limited ("the Company"). The Company is an audit client of your firm and Mr and Mrs Gerard are also personal clients in respect of their tax affairs.

The Company has traded for over twenty years within the property sector. The Directors have advised that the most recent development completed will be the Company's last and they wish to look at ways to wind the business up and release the capital from the Company.

The Company's balance sheet at 31 October 2018 is as follows:

Balance Sheet: Thorny Ltd

Assets	<i>Notes</i>	£'000
Heritable property	1	2,500
Leasehold property	2	100
Cash at bank		50
Debtors	3	750
Investments	4	1,735
Motor vehicles	5	50
Total		5,185
Liabilities		
Trade creditors		(300)
Taxes		(500)
Director's loan account	6	(200)
Bank loan	7	(750)
Total		(1,750)
Net assets		3,435
Share capital and reserves		
£1 Ordinary Shares		10
5% Preference Shares	8	1,000
Profit & loss account		2,425
Total		3,435

Notes:

1. The heritable property relates to the Company's final development of student accommodation in Aberdeen. An offer was received and accepted from the local University for the sale of the property at £3.5m and is due to complete in two weeks' time. The structure of the sale will see the sum of £2.8m being paid immediately with £600k being by way of loan notes and the remaining £100k placed into a retentions account, to be released 12 months from the date of sale. The loan notes will attract interest at 8% per annum.

2. The leasehold property is in Edinburgh. There are three years remaining on the lease that was assigned to the Company in 2011. The rent is £5,000 per annum.
3. The debtor monies are all due from a wholly owned subsidiary of the Company, Thorny (1035) Ltd. The balance sheet of Thorny (1035) Ltd as at 31 October 2018 is as follows:

**Balance Sheet: Thorny (1035)
Ltd**

Assets	£'000
Heritable property	2,000
Plant & equipment	450
Cash at bank	10
Debtors	350
Motor vehicles	150
Total assets	2,960
<hr/>	
Liabilities	
Trade creditors	(150)
Taxes	(75)
Inter-company creditor	(750)
Hire purchase	(200)
Bank loan	(50)
Total liabilities	(1,225)
<hr/>	
Net assets	<u>1,735</u>

Thorny (1035) Ltd is due to conclude the sale of some of its heritable property for £750k within the next 7 days

4. The investment relates to the 100% shareholding in Thorny (1035) Ltd.
5. The motor vehicles are two cars used by Mr and Mrs Gerard. Both cars are free of finance and Mr and Mrs Gerard would like to keep the vehicles.
6. The Director's loan account relates to Mr Gerard.
7. The bank loan is secured by a standard security over the heritable property and by a floating charge over the Company's assets and undertaking. The charge was registered on 18 April 2005.
8. The preference shares were issued to Mrs Gerard in 2010. The 2018 dividend, which was payable in August 2018, has not yet been paid.

9. The Company will, for the time being, continue trading after the completion of the sale of the heritable property to the University. It is anticipated that, following the sale, all the Company's employees will transfer to Thorny (1035) Ltd;
10. The Company has recently received a claim from the purchaser of one of the Company's properties. The sales contract was signed in 2016. Whilst the amount does not appear to be significant, the purchaser is threatening court action if this is not settled immediately. The sum being claimed is £15,000.

You have held an initial meeting with Mr and Mrs Gerard to go through the options available. They are keen to progress with a Members' Voluntary Liquidation.

Requirements

- (a) **Write a note to the Partner for whom you work. Outline the key areas for review and the further information that will be required prior to progressing his appointment as Liquidator. (5 marks)**
- (b) **Assuming that the Company is to enter Members' Voluntary Liquidation, draft a report to Mr & Mrs Gerard advising how each of the Company's assets and liabilities will be dealt with and mapping out the timeline for the overall process. (15 marks)**

Total: (20 marks)

Assumption: Tax at 20%

Question 4

Wheeler Turbines Limited (“the Company”) has approached you for advice regarding its current financial situation. You have established the following information relevant to the Company’s position.

Background

The Company manufactures components used in the wind turbine industry and it trades out of leasehold premises on the outskirts of Edinburgh. The Company employs 150 members of staff including the 3 directors.

On 1 October 2018, due to two VAT quarters and four months’ payroll taxes being overdue, HMRC presented a Winding up Petition at Court. Whilst the Company then attempted to negotiate a Time to Pay arrangement with HMRC, this was unsuccessful and this morning, 13 November 2018, the Winding up Petition was advertised in the Edinburgh Gazette. At 9.00am today the Company received a call from its bank confirming that the account had been frozen. Following this call the Company’s directors contacted you, an Authorised Insolvency Practitioner, for advice and provided you with the following information.

The court hearing in relation to the petition is scheduled for 27 November 2018.

Trading performance

The Company’s most recent management accounts available are summarised below together with related notes from your discussion with management.

Accounts for the 4 weeks to 30 September 2018

	Period ending: Number of weeks:	30-Sep 4	Year to Date 39
	Notes	£'000	£'000
Income	1	1,200	14,000
Materials	2	(660)	(8,400)
Labour	3	(300)	(3,500)
Gross profit		<u>240</u>	<u>2,100</u>
Overheads			
Administrative staff	3	(75)	(675)
Rent	4	(20)	(180)
Rates	5	(10)	(97)
Utilities	6	(8)	(78)
Depreciation		(70)	(630)
Sundry costs	6	(10)	(90)
Total overheads		<u>(193)</u>	<u>(1,750)</u>
Net profit before interest	7	<u>47</u>	<u>350</u>

Notes

1. The Directors expect sales to continue at the same weekly level as for the 4 weeks to 30 September 2018 for the foreseeable future. The Company’s customers pay extremely promptly with 25% of the week’s invoicing paid in that week and the remainder the following week.

2. The material cost for September was unusually low and management believe that the cumulative to date figure is a fairer representation of future costs. Whilst in the past the Company obtained trade credit for material purchases, given the situation in the future it will have to pay these costs on a pro-forma basis. Each week the Company will have to purchase 80% of that week's requirements and existing stock can be used for the remaining 20%.
3. Direct labour is paid weekly and administrative staff are paid on the 26th for the entire month. Payroll deductions including tax, National Insurance and pension deductions typically account for one third of the total cost.
4. Rent is due on the normal quarter dates.
5. The Company pays its non- domestic rates bill by direct debit on the 15th of the month.
6. Other costs are paid weekly.
7. Without prejudice to the terms of their facilities, the bank and hire purchase company have agreed that they will not seek payment of interest or any capital payments until the Company has entered into an insolvency process.

Balance sheet

Management has prepared an estimate of the balance sheet as at 12 November 2018 as follows:

Assets	<i>Notes</i>	£'000
Plant and Equipment	1,2	4,500
Cash at bank	3	65
Debtors	4	250
Stock	5	500
Total assets		5,315
Liabilities		
Trade creditors	2	(2,000)
Taxes		(3,500)
Hire purchase	1	(750)
Bank Loan	6	(250)
Total Liabilities		(6,500)

Notes:

1. The plant and equipment was subject to a valuation in September 2018 as follows:

	Book value	In situ	Ex situ
	£'000	£'000	£'000
Encumbered	1,500	1,200	750
Unencumbered	3,000	1,500	750
Total	4,500	2,700	1,500

The ex-situ valuations are based upon the special assumption as to the period of time the agent would have to market the assets for sale and is stated after the deduction of related holding costs. The encumbered assets are subject to a hire purchase agreement.

2. The Company has been experiencing significant creditor pressure and recently its landlord commenced enforcement action on 17 October 2018 for unpaid rent of £60,000. Since that date the Company has made two payments of £10,000 to the landlord in relation to this debt.
3. On 4 October 2018 a payment of £125,000 was made to one of the Directors and the reason for this is not clear. Other than this payment, all other recent payments have been in the normal course of business.
4. Management estimates that if there is continuity of supply 90% of the debts will be collectable. If the Company ceases trading, they anticipate that 25% of customers will refuse to pay.
5. The stock could be sold quickly, and it is estimated that it would realise, after costs, 60% of its value. None of the stock is subject to reservation of title claims.
6. The bank provides an unsecured loan. There are no charges registered against the Company.

Prospects for the business

Due to cash flow issues, in August 2018 management instructed a firm of accountants to market the business for sale. Following a thorough marketing process several offers were received from unconnected parties.

The best offer is from Penrose Components Limited, who have been made aware of the situation and have confirmed that their offer still stands. It is however conditional on it being completed as a sale as a going concern by an Administrator. If the Company enters liquidation their offer is to be considered withdrawn. The offer, assuming completion on 27 November 2018, is as follows:

- Unencumbered plant and machinery - £1,100,000
- Encumbered plant and machinery – £100,000 for the equity in the machines.
- Stock - £350,000
- Debtors – excluded
- Employees – transferred over together with their preferential claims of £75,000 and non-preferential claims of £450,000.

Of the total consideration £500,000 would be paid on completion and the remainder over 6 months.

Advice

The Directors are keen to avoid a closure of the business and the associated job losses. Therefore, they wish to pursue a sale of the business as a going concern and are seeking your assistance to place the Company into Administration.

Requirements

- (a) **List the key areas of information that a Court would require for it to consider granting a Validation Order. (4 marks)**
- (b) **Prepare a weekly cash flow forecast for the two week period commencing 13 November 2018, together with notes, in a format that could be included with the application for a Validation Order. (12 marks)**
- (c) **Assuming that a Validation Order, covering transactions undertaken in the normal course of business, is approved, and clearly stating all other assumptions, prepare an estimated outcome statement comparing Administration to Compulsory Liquidation as at the date of the hearing. (20 marks)**

- (d) In these circumstances set out the options as to how an administrator may be appointed. (4 marks)

Total: (40 marks)

Assumption: VAT @ 20%