

## JOINT INSOLVENCY EXAMINATION BOARD

### OVERALL COMMENTS ON THE NOVEMBER 2018 SITTING

#### Introductory remarks

The 2018 sitting was the first (in modern times) to offer just two papers, now Corporate and Personal Insolvency. At the same time the papers moved from 4 questions of 25 marks each to a 20/20/20/40 mark format. The introduction of 40 mark questions enables the Examiners, if they so desire, to explore candidates' knowledge of a particular subject, procedure or chain of procedures in more detail and greater depth.

As well as having to adapt to the new papers and formats, this sitting was the first where candidates moved to using computer-based exams. Regrettably, too many candidates faced issues with the computerised system and, in some cases, with examination hall conditions. These matters have been addressed elsewhere by the Joint Insolvency Examination Board and are not discussed in these remarks. The job of the Examination Team was to mark the scripts as presented. It is to candidates' credit that it was rarely evident from candidates' scripts that they had been faced with practical difficulties.

One happy consequence of moving to computer-based exams is that poor handwriting is no longer an issue. This was of substantial benefit to the Examination Team. However, in their individual reports the Examiners give a few tips on how candidates might improve layout and ensure that everything is visible to the Examination Team. Marks can sometimes be given for workings, even if the final product is wrong, but that is only possible when the workings can be seen.

Sadly, all the changes made in 2018 have not resulted in any material improvements in other areas where candidates have, in the past, lost marks. These have been highlighted in recent years but candidates, and those who teach and prepare them for the examinations, seem unwilling or unable to address issues which, if corrected, would mean that more candidates should present scripts that are obviously pass-worthy as opposed to being distinctly average. Candidates who present average scripts are running the risk that they will fall (perhaps by a small margin) the wrong side of the pass mark.

Candidates must read the requirements of the question carefully. For example, if the question requires a letter to be written, then a bullet point list is inappropriate. If the question asks for a recommendation or advice to be given, candidates must do this. Simply setting out the options is only half doing the job. If a question asks for advice to be given to a third party (as opposed say to an office holder) then candidates must do this. Too often candidates default to advising the office holder who will usually have objectives and duties that differ from those with whom he/she is negotiating.

Candidates continue to present scripts that demonstrate that they are able to identify the law or principles that are relevant, but that they are less able to apply that knowledge to solving the facts of the question. A better balance is required. There is still a tendency for some candidates to write checklists or disgorge all they know on a particular subject (or another related to it) without either considering whether it is relevant to do so or moving on to solve the problem at hand.

This year there were times when candidates needed to demonstrate basic knowledge beyond the confines of the Insolvency Act and associated Rules. An appreciation of how self-employed persons' tax affairs are managed and knowledge of directors' duties and obligations under the Companies Act were relevant considerations in two questions. Too many candidates

failed to show that they could “demonstrate a basic knowledge of taxation, accountancy and business law directly relevant to the performance of an insolvency office holder’s duties” (a direct quote from the syllabus). This is a significant weakness that candidates and those helping them must address.

There are still too many candidates who appear to be uncomfortable with “numbers”. The confident manipulation of numbers and the ability to prepare what is a fairly limited number of different sorts of financial statements and similar is a fundamental skill for an Insolvency Practitioner. The examinations will continue to test candidates’ ability to work with numbers and those candidates who are unable to do this to a good standard will materially reduce their chances of success.

Insolvency is essentially a practical, problem solving subject. A competent Insolvency Practitioner is able to assimilate facts and identify/devise workable solutions, all against a legal, best practice and regulatory background. He/she is able to apply a sound basic knowledge of the wider business world and key skills such as the ability to produce reliable financial statements (of whatever kind), together with softer skills such as the ability to communicate. Finally, he/she must be able to bring a healthy dose of common sense to everything he/she does. The principal objective of the examination will continue to be to identify those candidates who have the potential to become a competent Insolvency Practitioner.

**JOINT INSOLVENCY EXAMINATION BOARD**  
**CORPORATE INSOLVENCY EXAM SCOTLAND**

**EXAMINER'S REPORT AND MARK PLAN FOR THE NOVEMBER 2018 SITTING**

**General comments**

This was the first year of computer-based examinations and generally the format and readability of scripts had significantly improved compared to previous years. However, whilst the system allows basic calculations, candidates should ensure that their workings are fully set out as formulas are not visible when the script is marked.

Overall this was a fairly straightforward paper however most candidates seemed to struggle beyond the basics. Numerical questions are still posing problems. Candidates still have a tendency not to read the question and are therefore answering from a completely different perspective.

**Question 1**

This was a question relating to the procedures required to place a company into Creditors Voluntary Liquidation and in addition candidates were required to set out how they would deal with two situations relating to committee non-attendance and unpaid share capital.

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

Most candidates scored well here as a fairly straightforward question. Better candidates presented their answer chronologically and demonstrated they had dealt with the process before by listing the various forms for signing and filling.

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

For what should have been a straightforward question mostly taken from the act this was very poorly answered. Many candidates missed the fact that the committee would be inquorate due to contributory member to one candidate believing they would still be a member and required consulting so that matters progressed going forward.

Unpaid capital was poorly done with allot of time spent on dividends which, if candidates had simply said these could not be offset would have sufficed. Nobody mentioned S74 and only one candidate mentioned the fact they could look at overall costs and claims before deciding how much they could pursue from members.

## Markplan

### Question 1

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

Hold board meeting to pass resolutions to: wind up company, convene a general meeting and a creditors meeting, appoint a director to chair both meetings

S99 IA86 Directors to prepare statement of affairs accompanied by statement of truth. Notary public required to sign off

Need to give notice of resolution to wind up the company to any QFCH, resolution can't be passed until QFCH consents or 5bd have elapsed

Organise and hold a general meeting, 1) special resolution to wind up will be passed if 75% of attending and voting members agree and 2) ordinary resolution to appoint liquidator 50% attending and voting members to agree

GM can be held at short notice if consent of 90% of members obtained (95% plc)

If Liquidator appointed at members meeting then creditors meeting must be held within 14 days of GM

SIP 8 Summoning and Holding of Meeting of Creditors Pursuant to S98 of the Insolvency Act 1986

An advising member is reminded that he must have regard to the relevant primary and secondary legislation; and that if he intends seeking nomination as liquidator he must be qualified to act as an insolvency practitioner in relation to the company.

All members and their staff should conduct themselves in a professional manner.

SIP8 – Instructions to convene meetings

IP to make sure he is satisfied that the directors are fully aware of duties and responsibilities

Written instructions from the director (Engagement Letter)

Can act as advising member if had a previous MPR however must consider carefully whether this would breach code of ethics

SIP 8 – Venue and time of meeting must be convenient for creditors having regard to geographical location. Members meeting on same day as creditors?

SIP8 – Notice of meeting

7 days minimum although should be despatched as early as possible (7 clear days, excludes day of sending and day of meeting). Include with notice information relevant to SIP9

Advertise in gazette and two local newspapers

SIP 8 – Information Prior to Creditors Meeting

Make available to creditors on two business days before meeting. SoA information and creditors details (claims etc). Usually at IP office.

SIP 8 – Attendance at meetings

Liquidator appointed at shareholder meeting must attend creditors meeting personally and report on any powers exercised under Sections 112, 165 or 166 IA 1986.

Director nominated to chair meeting however IP usually assists

SIP8 - Need to provide certain information (in addition to that required by statute) to the meeting of creditors, to include:

Any prior involvement of the IP with the company and/or directors

Report of the previously held shareholders meeting

Date instructions to IP and who gave them

Any amounts paid by or on behalf of the company in respect of those instructions and to who paid

Summary of company's relevant trading activity and financial history

Statement of company's affairs with a deficiency account

Names and professional qualifications of any valuers whose valuations have been relied upon

Creditors to sign attendance register and vote at meeting if valid claim lodged and accepted. Proxies also to be reviewed and accepted for voting purposes

Nominations for appointment of Liquidator sought at meeting before any vote

Proposed liquidator to provide chair with a written statement that they are an IP, duly qualified to act as liquidator and that they consent to act

Appointment of liquidator certified by the convenor (Form 4.8). Certificate provided to liquidator.

File Form 600 and resolutions with AiB/Resolutions with ROC post meeting

Practical considerations –, identifying all creditors, organising and holding board and general meeting, legal proceedings commenced against company? Centrebind required? Company bank accounts and funds held to order. Security of assets, insurance, valuations, safeguarding in general in run up to appointment.

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

If a committee member fails to attend three consecutive meetings then their membership of the committee is automatically terminated

Ascertain if this rule was resolved not to apply at last committee meeting, and if so termination is not automatic

Contact committee member to ascertain whether wish to remain member of the committee

If the member represented a company, confirm that company which they represent wishes to resign from the committee, rather than individual, and therefore can they just change representative?

Liquidation committee must have at least 3 creditor members

If vacancy arises, as creditor members will fall below three, Liquidator may appoint a creditor replacement as long as other creditor members consent and creditor agrees to act, therefore need to first identify suitable replacement who is acceptable to other creditor members and who consents to act

If no suitable replacement can be found, would need to seek a decision from creditors to appoint a vacancy or else committee will be inquorate, notwithstanding contributory member

Need to notify Registrar of Companies asap re change in membership of committee

A contributory is a person liable to contribute to the assets of a company in the event of its being wound up, liability would extend to the amount, if any, remaining unpaid on shares held by them – here £80,000.

S74 (2)(a), check whether contributories ceased to be members more than a year before the company was wound up, as if so they are not liable to settle their unpaid balance

S74(2)(f) unpaid dividends not deemed to be a debt of the company so £10,000 can't be set off

Confirm whether other realisations (excluding any unpaid shares) will be sufficient to settle the payment of debts, liabilities and expenses

Write to contributories asking them to settle unpaid amounts, consider debt enforcement if fail to pay

## Question 2

This question, set within a compulsory liquidation situation, asked candidates to provide the directors with advice in relation to five different aspects.

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

Overall poorly answered question due to the fact majority of candidates did not read the question and were not preparing a note to advise the director. A lot of this could have been taken from the act then simply applied a practical approach to the circumstances of the question.

EBT dealt with poorly and demonstrated little practical experience of this area. Nobody sought to apply the legislation to the phoenix company and assets and advise the directors that they could purchase the assets and seek the first exception, whilst also mentioning why the second and third exceptions didn't apply here.

Most candidates missed wrongful trading on the claim because they were too focussed on advising a Liquidator to lodge claims and pursue the debtor. No candidate mentioned about the director's potential risk of bankruptcy if any of the claims were successful or the fact the director could negotiate on the claims where a Liquidator was likely to be successful. Lack of fiduciary duties mentioned which could have picked up extra marks. Most candidates even forgot to head up the file note.

Candidates must ensure that they write their answers from the correct perspective; in this scenario it was advice to the directors. Some candidates wrote their answer as if they were the liquidator or were advising the liquidator.

## Markplan

### Question 2

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 matters. (20 marks)

Name	<p>S216 Re use of company name</p> <p>Applies to directors during the 12m prior to liquidation</p> <p>Applies to a name so similar as to suggest an association. Proposed name will fall within this definition</p> <p>Unless court agrees, or correct process followed, being a director of the new company would breach the restriction.</p> <p>If breach the provisions the director may be liable to imprisonment or a fine</p> <p>Under s217 also personally liable for debts of the new company.</p> <p>Rules 4,78 to 4,82, of Insolvency (Scotland) Rules 1986 sets out exceptions and process:</p> <p>4.80: First exception</p> <ul style="list-style-type: none"><li>• Purchasing the business or substantially the whole of the business from the liquidator</li><li>• Prior to acting in contravention to the act the director</li><li>• Gives notice to the company creditors</li><li>• Publishes a notice in the Gazette</li><li>• May be given prior to purchasing the business or within 28 days of acquiring it</li><li>• Must contain prescribed information</li></ul> <p>4.81 Second exception</p> <ul style="list-style-type: none"><li>• Apply to court for permission</li><li>• If apply no later than 7 days after liquidation, then directors can trade until the hearing (max 6 weeks). Too late in this case unless already made.</li></ul> <p>4.82 Third exception - Doesn't apply; question states new company.</p>
Asset sale	<p>SIP13 – Disposal of assets to connected parties in an insolvency process – for market value, at arm's length, transparency of dealings, formal valuation required</p> <p>Disclosure will be required by the liquidator</p>
Trading	<p>S214 Wrongful trading</p> <p>At some time before the commencement of the winding up that person knew or ought to have concluded that there was no reasonable prospect of avoiding liquidation.</p>

	<p>Defence is that the person took every step to minimise the loss to creditors.</p> <p>Significant debt write off known in May 2018 but continued for several months</p> <p>The debt value reduced to c. £3,750; unlikely to be sufficient to pay debts?</p> <p>Evidence of insolvency due to non-payment of creditors and CCJs</p> <p>Is there evidence that there was a reasonable prospect of avoiding liquidation – board minutes, forecasts?</p> <p>Establish what the loss was over that period</p> <p>Directors may be personally liable for the loss to creditors.</p> <p>Also risk of S212 Misfeasance and disqualification</p>
EBT	<p>S423 actions defrauding creditors – will depend on purpose of scheme here likely tax avoidance</p> <p>HMRC pursue them for potential personal liability in respect of NIC elements of tax savings</p> <p>As 6 years has passed since scheme implemented it may not be possible for liquidator to ‘unwind’ it (unless fraud).</p> <p>HMRC may still be able to pursue and issue Advance Payment Notices</p>
Consultancy Services	<p>S243 Preference</p> <ul style="list-style-type: none"> <li>• may be able to defend his position if he is the largest creditor</li> <li>• Connected party therefore payments within relevant period</li> <li>• Appears that the company was insolvent for at least part of this period.</li> <li>• Would need to review when payments made and whether other creditors were being paid at the same time.</li> <li>• May have to repay funds</li> </ul> <p>Companies Act 2006 Duty</p> <ul style="list-style-type: none"> <li>• Duty to avoid conflicts of interest (s175 CA2006)</li> <li>• A duty to disclose any interest in a proposed transaction or arrangement with the company and a separate and independent duty to disclose any interest in an existing transaction or arrangement with the company (transactional conflicts) (s.177)</li> <li>• Such arrangement must be approved by shareholders or board (if shareholders have provided that power)</li> <li>• Failure to declare an interest in an existing transaction or arrangement with the company is a criminal offence</li> </ul>
Arla TUV	<p>S242 Transaction at an Undervalue</p> <ul style="list-style-type: none"> <li>• Appears to be a gift</li> <li>• To a connected party</li> <li>• Payments in the last 2 years likely to have to be repaid</li> <li>• Possibly both directors and daughter personally liable to repay</li> </ul>

	<p>Tax</p> <ul style="list-style-type: none"> <li>• Tax should have been paid on these amounts as a benefit in kind</li> <li>• Could be a liability for his daughter and/or Ned depending on structure of payments;</li> </ul> <p>Breach of duty – difficult to see how this promotes the interests of the company</p>
Other	<p>Conduct Report</p> <p>Ability to pay</p> <p>Personal insolvency risk if can't pay back etc</p>

### Question 3

- (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)**

Most candidates missed the point and simply noted down everything they knew about ethics. Question asked for key areas to consider to progress an appointment as Liquidator and was looking for the candidates to take all the information available and review the commercial and practical considerations based on the information. Hardly anybody mentioned distributing in specie or checking loan notes to see if they could be assigned or reviewing any warranties which may cause an issue for future.

There were plenty of areas to cover to score marks yet candidates missed the bulk of these and easy marks.

- (b) **Assuming that the Company is to enter Members' Voluntary Liquidation, draft a report to Mr & Mrs Gerrard 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)**

Some really good answers and some really poor attempts. Better candidates recognised they would set out as essentially a statement of affairs which would show the flow of funds and ultimately the return to shareholders, along with making assumptions on being able to distribute assets out in specie which would affect timelines.

### Question 3

**(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.**

**(a)** Ethical considerations. Satisfy yourself that no threats to fundamental principles given the company and shareholders are clients.

Review sale of student accommodation. Seek copy sales contract and review for any warranties. Highlight warranty periods.

Review timing of cessation of trade and confirmation trade ceased prior to any meeting. Confirmation all employees TUPE'd.

Obtain and review loan notes to establish if these are able to be distributed in specie as this will dictate time Liquidation required to remain open and also costs of process.

Review company's articles to establish if assets can be distributed in specie, if not consider changing.

Obtain and review copy of leasehold interest in property at Edinburgh. Establish if any value and if it can be assigned

Review sale of property in Thorny (1035) Ltd to see if this results in immediate payment of debtor

Establish intentions for Thorny (1035) Ltd post sale of property. Do shareholders wish to keep this company (i.e. distribute investment in specie) or has Thorny (1035) Ltd to be sold/wound up to realise the investment.

DVLA searches on vehicles and HPI checks to ensure free of finance.

Review of director's loan account, will this increase to point of Liquidation? Obtain bank statements. Confirm if this is being repaid pre or post Liquidation.

Review status of potential court action. Obtain details of claim and sale contracts for warranties given.

Review of company's creditors to ensure all captured. Obtain information from company and accounts team.

Review and consider generally how to approach the MVL in a cost effective manner i.e. realising assets and paying creditors before commencement.

Tax advice – specialist tax advice required and to be factored in to any pre appointment planning. Obtain all HMRC details including reference numbers

Obtain the thoughts of the shareholders and review how they wish to extract the value in the company. Shareholders will require their own specialist tax advice on capital distributions received however they will look for the most tax efficient way to extract value on their shareholding.

- (b) Assuming that the Company is to enter Members' Voluntary Liquidation, draft a report to Mr & Mrs Gerrard advising how each of the Company's assets and liabilities will be dealt with and mapping out the timeline for the overall process.

#### REPORT TO SHAREHOLDERS OF THORNY LTD

	Notes	BV £'000	ETR £'000
<b>Assets Subject to Standard Securities</b>			
Heritable Property	1	2,500	2,800
Less CGT	2	-	(200)
Less Due to Bank		(750)	(750)
Loan Notes	3	-	648
Retentions	4	-	100
<b>Surplus under standard security</b>			<b>2,598</b>
<b>Assets Subject to FC Securities</b>			
Leasehold Property	5	100	-
Cash at bank		50	50
Debtors	6	750	750
Investments	7	1,735	1,735
Motor Vehicles	8	50	50
<b>Assets available to unsecured creditors</b>			<b>5,183</b>
<b>Liabilities</b>			
Trade creditors	9	(300)	(315)
Taxes	9	(500)	(500)
Directors Loan Account	10	(200)	(200)
<b>Surplus available to Shareholders</b>			<b>4,168</b>
<b>Shareholders</b>			
Preference Dividend	11	(50)	(50)
Preference Shares		(1,000)	(1,000)
Ordinary Shareholders		(10)	(10)
<b>Surplus available to Ordinary Shareholders</b>			<b>3,108</b>

**General** All debts to be paid in full plus interest within 12 months of the declaration of solvency.

Liquidation should only go beyond this if assets still to realise. Consideration should be given to dealing with as many issues pre Liquidation in order to minimise costs for shareholders.

Based on information available it should be possible to settle all debts within 12 months however the Liquidation may go beyond 12 months slightly to deal with some assets.

**Note 1 to Report** Assume sale completes pre Liquidation and funds are held within the Company bank account on appointment.

- Note 2 to Report** Any reasonable assumption .Shareholders should be aware of potential liability and should be settled as part of seeking clearance from HMRC upon appointment.
- Note 3 to Report** Any reasonable assumption. Prior to sale should ensure provision built into sales contract that these are able to be assigned and ultimately distributed in specie should they not be repaid within 12 months of Liquidation. Assumed assigned to shareholders at 12 months as they have not been repaid.
- Note 4 to Report** Any reasonable assumption. Should monitor and collect as soon as 12 month period expires.
- Note 5 to Report** Any reasonable assumption. Unlikely to be value here however should be valued.
- Note 6 to Report** Sub is solvent and debtor balance should be collected on sale of Thorny 1035 property.
- Note 7 to Report** Investment should be collected and any reasonable assumption here. Assumed Thorny 1035 Ltd shares are transferred to shareholders (distribution in specie).
- Note 8 to Report** Distribute vehicles out in specie on appointment to shareholders per wishes.
- Note 9 to Report** Trade creditors and taxes to be paid in full. Try and settle as much prior to appointment. HMRC clearance to be obtained within 12 months of Liquidation.  
Assume claim from previous purchaser is valid and settled.
- Note 10 to Report** DLA to be repaid.
- Note 11 to Report** Preference dividend to be paid Mrs Gerrard.

#### Question 4

Following the introduction of a Corporate exam, this was the first 40-mark question and was relatively number intensive including a cash flow and outcome statement.

- (a) List the key areas of information that a Court would require for it to consider granting a Validation Order. (4 marks)**

Poorly answered by candidates. A lot of candidates got confused and were looking to validate historic transactions rather than the two week trading period. Some candidates got a few key areas that would be included within the application but missed the very basics including details of the Liquidation petition that was outstanding.

- (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 an application for a Validation Order. (12 marks)**

Most candidates couldn't deal with the VAT and simply did not include VAT on Income or Payments. PAYE elements confused candidates. Nobody brought forward debtors figure from management accounts. Nobody calculated correct materials required and stock deductions.

Rent and rates varied with some candidates paying full month rather than pay as you go. Some candidates got the layout fine with running totals.

- (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)**

No candidate dealt with depreciation on NBV for the two week period. Most managed to get the basics down however more complex calculations that would have come through from cashflow were not dealt with well. Layout in most papers was fine and getting the basics down however struggled on stock, debtors and landlord due to not being able to deal with this in part (b).

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

A mixed response here with the better candidates recognising that only a court application for appointment could be made due to the outstanding petition and providing options how to deal with the outstanding petition practically. Some candidates sought to focus on the mechanics of the appointment which is not what the question asked.

#### Question 4

**List the key areas of information that a Court would require for it to consider granting a Validation Order. (4 marks)**

Order to enable the company to continue trading in the ordinary course of business.

Practice direction – insolvency proceedings

- Who notice of application given to
- Statutory information including registered office, capital
- Background information as to why the petition was served
- How it found out about the petition
- Whether the debt is admitted or disputed
- Details of the company's financial position
- Copy of last accounts, management accounts or statement of affairs
- Cash flow forecast and profit and loss account for the period the order is being sought
- What dispositions are being sought
- Reasons for the dispositions
- Why dispositions beneficial to the creditors
- Details of the bank account – number, address, sort code, bank, balance
- Any other information relevant to the circumstances.

**Prepare a 2-week cash flow forecast for the Company together with notes, in a format that could be included with the application for a Validation Order. (12 marks)**

Cash flow	NOTES	week ending	week ending
		21/11	28/11
		Week 1	Week 2
		£'000	£'000
<b>Summary</b>			
Income	(a)	340.0	360.0
Materials	(b)	(172.8)	(172.8)
Labour	(c)	(50.0)	(100.0)
Tax and other deductions	(c)	(25.0)	(50.0)
Rent	(d)	(6.0)	(6.0)
Rates	(e)	(2.5)	(2.5)
Utilities	-8/4*(1+20%VAT)	(2.4)	(2.4)
Sundry costs	10/4*(1+20%VAT)	(3.0)	(3.0)
Legal and professional costs	Any reasonable assumption	(12.0)	(12.0)
	No VAT		
	VAT payable		
Sub total		66	11
Output VAT	(f)	(60.0)	(60.0)
Input VAT	(f)	32.7	32.7
VAT Payable		(27.3)	(27.3)
Total		39	(16)

## NOTES

### (a) - Income

September weekly sales	1200/4	300.00
VAT	20%	60
Total invoiced		360.00

Paid in week	25%
Paid week after	75%

	WEEK 1	WEEK 2	TOTALS
Week 1 sales	90	270	360
Week 2 sales		90	90
Debtors	250		250
Total receipts	340	360	700

VAT (included in above)	60	60	120
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### Expenditure

### (b) - Materials

Cum to date % of sales	8400/14000	60%
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		WEEK 1	WEEK 2	TOTALS
Total stock required	0.6*300	180	180	360
Taken from stock	20%	(36)	(36)	(72)
To purchase		144	144	
VAT	20%	28.8	28.8	58
Total payments		172.8	172.8	346

**(c) - Labour**

		WEEK 1	WEEK 2	TOTALS
Weekly	300/4 or 25%*300	75	75	150
Monthly	75		75	75
Total		75	150	225
Deductions	33.3%	(25)	(50)	(75)
Net pay		50	100	150

Assumed that payroll deductions are made at the same time as payroll to avoid increasing / prejudicing HMRC position

**(d) - Rent**

		WEEK 1	WEEK 2	TOTALS
Weekly	-20/4	(5)	(5)	(10)
VAT	20%	(1)	(1)	(2)
		(6)	(6)	(12)

Assumed pay weekly to avoid prejudice to landlord  
Assumed VAT charged

**(e) - Rates**

Most companies pay over 10 instalments  
Assumed that the Company would only pay the amount accrued over the period

		WEEK 1	WEEK 2	TOTALS
Weekly	-10/4	(2.5)	(2.5)	(5.0)

**(f) - VAT**

Assumed that would have to include VAT payable in validation order to protect HMRC position

		WEEK 1	WEEK 2	TOTALS
Output VAT				
On sales	See note (a)	60	60	120
Input VAT				
Materials	See note (b)	28.8	28.8	57.6
Rent	See note (d)	1.0	1.0	2.0
Sundry costs	10/4*(20%VAT)	0.5	0.5	1.0
Utilities	8/4*(20%VAT)	0.4	0.4	0.8
Legal and professional costs		2.0	2.0	4.0
		32.7	32.7	65.4
Net VAT		27.3	27.3	54.6

**Explaining your assumptions, prepare an estimated outcome statement comparing administration to compulsory liquidation as at the date of the hearing and assuming that the validation order is approved. (20 marks)**

**PART C**

Estimated outcome statement of Wheeler Turbines Limited

As at 23 November 2018

	Note	Book Value	Movement over 2 weeks	Book value at 23 November 2018	Administration	Liquidation	Assumption
		£'000	£'000	£'000	£'000	£'000	
<b>Assets subject to HP</b>							
Plant and Equipment	valuation = 1500/4500* -7	1,500	(12)	1,488	100	750	Equity in administration could be presented as unencumbered
Amount due to HP Company		(750)		(750)	0	(750)	In Administration liability settled/transferred
Realisation costs	Assumed 5%				-	(37.5)	Any reasonable assumption
<b>Surplus/deficit</b>					<b>100.0</b>	<b>(37.5)</b>	
<b>Assets not specifically pledged</b>							
Plant and Machinery	valuation = 3000/4500* -7	3,000	(23)	2,977	1,100	750	Administration assumed offer level
Cash at bank	From part B	65	23	88	88	88	
Debtors	Note (i)	250	20	270	243	202.5	
Stock	Note (ii)	500	(72)	428	350	257	
<b>Total assets not specifically pledged</b>					<b>1,781</b>	<b>1,297</b>	
<b>Surplus from HP assets</b>					<b>100</b>	<b>-</b>	
Landlord claim	Note (iii)				1,881	1,297	
Dispositions	Note (iv)				(40)	20	
<b>Amount available for costs</b>					<b>1,941</b>	<b>1,442</b>	
Petitioners' cost - Administration fee					-	(5)	
Petitioners' costs - Deposit	Would be refunded				n/a	n/a	
Petitioners' legal costs	Borne in both processes				(1)	(1)	Any reasonable assumption
<b>Costs of administration application</b>	Assumed borne in both cases				<b>(5)</b>	<b>(5)</b>	Any reasonable assumption
Officeholder costs	Note (v)				(75)	(216)	
Legal costs	Assumed higher in admin due to business sale				(25)	(15)	Any reasonable assumption
Agent's costs	Assumed higher in liquidation as break up basis				(5)	(15)	Any reasonable assumption
<b>Amount available for preferential creditors</b>					<b>1,830</b>	<b>1,185</b>	
Preferential creditors	Per question				-	(75)	Assumed redundant in liquidation
<b>Amount available for non-preferential creditors</b>					<b>1,830</b>	<b>1,110</b>	
<b>Non-preferential creditors</b>							
Trade creditors	(landlord £40k deducted)				(1,960)	(1,960)	
Landlord					-	(60)	
Taxes					(3,500)	(3,500)	
Bank Loan	Per question				(250)	(250)	
Employees	Per question				-	(450)	
<b>Deficit to non-preferential creditors</b>					<b>(3,880)</b>	<b>(5,110)</b>	

Note (i) - Debtors		WEEK 1	WEEK 2	Change
Brought forward		250	270	
Sales		360	360	
Cash collection	See part B	(340)	(360)	
Carried forward		270	270	20

REALISATIONS	Administration	Liquidation
Book value	270	270
provision	10%	25%
Estimated to realise	243	202.5

Note (ii) - Stock		WEEK 1	WEEK 2	Change
Brought forward		500	464	
Materials used	See part B	(36)	(36)	
Carried forward		464	428	(72)

REALISATIONS	Administration	Liquidation
Book value	428	428
provision	£350k per offer, 60% closure (78)	(171)
Estimated to realise	350	257

#### Note (iii) - Landlord claim

Unpaid rent	60,000
Payments made	(20,000)
Amount due to landlord	40,000

Assume landlord paid in full under Hypothec  
Payments to Landlord void under s127

REALISATIONS/EXPENSE	Administration	Liquidation
Paid to landlord	(40)	
Void payments		20
Total impact	(40)	20
Revised landlord claim	-	60

#### Note (iv) - dispositions

Under s127 any property dispositions void post issue of the petition  
Validation order likely to seek retrospective approval for dispositions in the normal course of business up to date of order  
Could also be challenged as Transaction at an undervalue or preference. Available in both Administration or liquidation  
Costs of pursuing TaU or Preference likely to be more than s127 as there are defences.

	Administration	Liquidation
Payment to director		
s127 disposition		125
Preference TaU	125	
Provision	Any reasonable assumption (25)	-

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

- No QFC so this route is not available
- Whilst petition is outstanding cannot appoint out of court
- If petition was dismissed it would be possible for directors to appoint administrators out of court
- Unlikely petition would be dismissed until administrators appointed; more likely adjourned.
- Therefore, court application required
  - Directors could make application
  - (Alternatively, an unsecured creditor could apply for an administration order)
  - Application could run in parallel to the petition and be heard together at the same court hearing
  - Seek dismissal of the petition at the hearing to make the administration order

**JOINT INSOLVENCY EXAMINATION BOARD**  
**PERSONAL INSOLVENCY EXAM SCOTLAND**  
**EXAMINER'S REPORT AND MARK PLAN FOR THE NOVEMBER 2018 SITTING**

This was the first year of both the new format of the Personal Insolvency Exam and the use of electronic examinations.

In the first year of the new format, the questions were generally “mainstream” and in all scenarios the candidate was answering from the perspective of an Insolvency Practitioner. Topics covered included payment to finalise a sequestration in full, a property partnership facing difficulty, setting a DCO and advice to a lossmaking sole trader. The numbers content was the preparation of a straight forward profit and loss account.

From an Examiner's perspective the marking of the exam was significantly easier due to the speed of transmission of scripts (hours after sitting the exam) and no issues with legibility of handwriting. The structure of answers was better and there was also less repetition of points in comparison to handwritten scripts.

It was pleasing that there was very little in the way of irrelevant content/“brain dumps” in the answers to this paper.

In terms of overall themes, however, there did seem to be a weakness in the advice about options available to an individual facing difficulty. This is not something that can be learned from a bullet point list and candidates need to show that they properly understand when an option is appropriate and that they can adapt their answers to the scenario given in the question.

## Question 1

This question explored the options available to Mr & Mrs Mallard to deal with Mrs Mallard's sequestration and the Trustee's interest in her share of the equity in their jointly owned property.

### Requirements

**Write a letter to Mr and Mrs Mallard setting out the options. The letter should detail any further information that is required and recommend a course of action.**

**(20 marks)**

To answer this question candidates needed to recognise that although Mr Mallard had been provided with a "Pay in Full" calculation by the Trustee, this may be only part of the story as the equity in Mrs Mallard's share of the property could be less than the funds required to pay in full.

If the equity were less than the funds required to pay in full the Mallards should to make an offer for the equity (suitably adjusted) as Mrs Mallard is not obliged to pay in full in these circumstances. If the pay in full figure is lower than the equity then they should seek to reduce the sum required to pay in full. If funds were not available for either option the Mallards could agree to a sale or defend a legal action.

This is a reasonably common scenario in cases with significant asset value and it can be confusing for debtors. Very few candidates were able to identify these initial points or explain it in any coherent way, which is disappointing as this would be expected of an IP.

This lack of clarity/structure, then made it difficult to score high marks. Many candidates went firmly down one route or the other cutting off a number of marks.

Only a small number recognised the issue of whether statutory interest would be payable in a recall scenario, or alternatively whether there was any scope for negotiation with creditors regarding the interest payable. This has been examined in recent papers and is topical within the Profession.

There was limited comment on any wider holistic considerations for the Mallards and their options to raise funds.

One candidate suggested taking advice from an insolvency specialist. Whilst negative marking does not apply, candidates should be aware that Holistic Marks will be affected by such a suggestion in the context of a question that states you are an Authorised Insolvency Practitioner during an exam whose purpose is to determine whether you have the knowledge required to be one.

On the positive side the letter format was consistently adopted when answering the question. Although in some cases the structure could be improved, effort had clearly been made. Candidates were also able to make sensible points about the HMRC claim.

## Personal Insolvency 2018 Marking Plan

### Question 1 (20 marks)

Letter format

Letter structure throughout

As she has no other assets, Mrs Mallard's obligation is either to provide funds to relinquish the Trustee's interest in the property **OR** provide the funds required to pay creditors and costs in full and finalise the sequestration which ever figure is lower.

#### Options

Notwithstanding that the Trustee has provided a figure to finalise, if the estimated equity in Mrs Mallard's one half share of the property is less than the amount required to pay creditors plus interest and costs in full, a third party on behalf of Mrs Mallard could put forward an offer to purchase the Trustee's interest in the Property. This offer could also deduct the sums which the Trustee would otherwise incur if he were to sell the property.

If the estimated equity in the half share is higher than the amount required to discharge the sequestration in full, Mrs Mallard could pay this sum and avoid the Trustee raising legal proceedings which will incur cost.

If funds cannot be raised or if it is the preferred option, the Mallards could agree to a consensual sale.

If none of the above happen then it is likely that the Trustee will force the sale of the property.

#### Forced sale

The third anniversary of the making of the sequestration is 12 April 2019. The Trustee must take steps to realise his interest in the property prior to this date to ensure that the property does not re-vest.

If no sensible offer is made, the Trustee is likely to instruct solicitors to commence an action for division and sale followed by eviction shortly. If Mrs Mallard intends to make a proposal contact should be made with the Trustee as soon as possible, with a request made that he refrain from issuing proceedings for a short time in order to limit costs.

Defending an action is unlikely to succeed unless there are any circumstances that we are not aware of, for example extreme health issues.

#### Proposal for Equity

Mrs Mallard should be asked to confirm the equity position in the Property through any indicative valuation she has previously been given and obtaining a copy of the RICS valuation which will have been obtained by the Trustee. A redemption statement in respect of any mortgage/ charges secured against the property would be required.

Confirmation should be requested from the Mallards that the property is owned jointly which can also be confirmed by a property search.

The amount which the Trustee would realise from the sale of the half share would be less than simply the half share of the equity as he would incur costs to market and sell even in a consensual sale. If legal action was protracted and defended he could incur significant legal costs. He has provided for £6,240 in his own calculations. The Mallards could make him aware of their intention to defend proceedings and request at least this figure plus marketing/conveyancing costs be deducted from the equity figure.

### **Funds required to pay in full**

Whilst the Calculation states that £96,164 is needed to discharge the liabilities in full, if Mr Mallard were to draw down the maximum lump sum of £75,000 available to him, this might be sufficient to discharge the liabilities of the bankruptcy estate for the following reasons.

It is possible based on what Mrs Mallard has advised that HMRC's claim is based on an assessment (estimate) of the tax due for the period since she last submitted a return. Since she has stopped trading in this period then this is likely to be significantly overestimated. Mrs Mallard should check when a return was last filed and arrange to submit any outstanding returns. She should then request that HMRC confirm the revised amount of their claim.

Any penalties for late submission of the returns will still stand.

Provision has been made within the calculation for legal fees, if no action need be taken in relation to the property then these fees will not be required.

Similarly if an agreement can quickly be reached with the Trustee this will ensure that the Trustee's future time costs are kept to a minimum.

Both of the above will have the effect of limiting the AIB Audit Fee as this is 17.5% of fees and outlays.

### **Recall of sequestration**

Mr and Mrs Mallard could contact the creditors directly to arrange payment of the sums outstanding. This would minimise the Trustee's future time costs.

Following payment being made, written confirmation should be sought from the creditor that it has no further claim against the bankruptcy estate.

Recent guidance from AIB confirms that statutory interest does not need to be paid to creditors during the recall process. With statutory interest estimated to be c£13,800 (before any reduction on the HMRC claim) this would make a significant difference to the sum required. Creditors could object to the recall on the grounds that they would be otherwise entitled to statutory interest. This is currently being tested in the Courts. It would be prudent to seek agreement from the creditors in writing prior to commencement of the recall.

The Petition costs could also be subject to challenge if the costs were not taxed. The petition costs seem slightly high however, any reduction is likely to be minimal.

If Mrs Mallard was VAT registered then VAT could be reclaimed thereby reducing the overall cost.

If statutory interest and legal costs can be avoided, these alone will reduce the funds required by c£20,000 which would bridge the gap between the funds requested and those available.

If there is a realistic chance of the HMRC debt being significantly reduced then this would further reduce the sums required.

### **Funding of payment to finalise sequestration/recall**

Having minimised the payment required, the Mallards need to carefully consider how to fund it in the most sensible way bearing in mind their future requirements, advice from an IFA would be sensible.

As noted Mr Mallard can draw down a sum from his pension of £75,000 this may be enough.

As noted above the extent of the equity in the property needs to be considered. The Mallards are now retired but an equity release scheme could be considered.

They should also consider whether realistically, a sale of the property would be the best option and if so, it would be better to do this consensually, maximising realisations and minimising cost.

It should be noted however, that any realisation from a sale of the property would have to be paid to the Trustee, who would then be obliged to pay statutory interest unless waived. It may therefore be best to provide 3<sup>rd</sup> party funds to the Trustee unless a waiver of interest can be obtained from all creditors.

If third party funds are to be introduced then AML check would need to be carried out by the Trustee to ensure he knew the source.

**Recommended course of action.**

On assumption that the equity is not significantly less than the figure to finalise, engage with HMRC and submit required returns to reduce claim. Utilise pension funds to pay creditors in full seeking their confirmation in advance that if debt is paid they would forgo statutory interest. Make application for recall of the sequestration.

Ensure Trustee kept advised throughout.

## Question 2

This question described a scenario which has been common over the last decade where property businesses, no longer able to rely on continuing property growth to fund losses, have failed.

### Requirements

**Set out your advice to the brothers on:**

- (i) the potential implications for them if the Bank facility is not renewed in February 2019; (8 marks); and**

The challenges in this part of the question were recognising that the brothers were jointly and severally liable for the debts due by the Business trading as a partnership and understanding what the Bank could do. On the whole this part of the question was answered well.

**what options are open to them in the circumstances. (12 marks)**

The candidates who did well in this section were those who explored the wider options such as a consensual sale, refinancing, and negotiating debt forgiveness from the secured lender recognising that insolvency was not a foregone conclusion, and even if it was the Brothers had much to gain by working with the lender through this process to limit the call on their personal assets. Unfortunately there were a number of candidates who read “options” and simply outlined the available statutory debt solutions and the pros and cons of each. This in itself presented some issues as some candidates had some fairly sketchy knowledge of what would happen in these scenarios.

Some candidates completely ignored the rights of the secured creditor over the properties in discussing the options open to the Brothers.

### Question 3

This question required candidates to advise a debtor on some common issues that would be experienced in a sequestration, including the setting of a DCO, equity in a property, and pensions.

This question was the best answered in the paper with candidates coping well with familiar issues and benefiting from the question being structured into separate parts covering different issues.

#### Requirements

**In advance of your meeting, and clearly stating any assumptions you have made, prepare a note that sets out what you propose to say to Mr Eider about:**

**(i) his requirement to make a contribution from income; (10 marks);**

Candidates were able to explain the process of setting a DCO in theory however, were perhaps lacking in practical experience. Few raised an issue over whether a provision was required for income tax. Most were also silent on the question of the treatment of some of the more contentious items of expenditure, such as School Fees, or the vehicle lease. Those who did comment often took a firm view one way or another without recognising that there are various considerations and there could be further information you would want to obtain.

**(ii) his continued residence in the property; (4 marks);**

The answers to this part of the question were generally good

**(iii) his release from his liabilities (3 marks); and**

While most candidates were able to recognise that Mr Eider would not be discharged of his ongoing liability to pay aliment, few commented on whether he would be discharged of his liability for costs or the capital sum which would be hugely relevant to Mr Eider.

**(iv) his pension; (3 marks).**

Again the answers to this part of the question were good. It should be noted that if candidates are going to refer to a legal case (Horton in this answer) they should know in what context to raise it. Simply knowing that Horton has something to do with pensions is not enough.

## Question 4

This question dealt with a sole trader facing difficult trading conditions and the options he had available and then considered the position following his subsequent death.

This was the last question in the paper and also the longest. The latter part of the questions carried some very easy marks. Carefully reading the paper at the outset would have identified this and one approach would have been to quickly answer these securing these marks. Unfortunately some candidates appeared to run out of time and provided only very hasty answers in the latter stages of question 4.

### Requirements

- (i) **Prepare an estimated profit and loss account for Mr Gadwall's business for the year to 31 December 2018. Set out your supporting calculations and state what assumptions you have made. Ignore VAT. (10 marks)**

This required the preparation of a very simple profit and loss account and it should have been possible to achieve full marks. Around 1/3 of candidates scored highly. The weakest marks were from those who simply put in numbers without explanation. For example, the sales number without showing their workings. Very few candidates actually understood the difference between Gross profit % and mark up and very few got this final step correct and as a result the sales figure was wrong. Those whose calculations were correct until that point could still score well. Those who simply wrote down an incorrect number did not get marks for it.

There are still issues with the formatting of a P&L and in some cases confusing cash flow with P&L but overall the format was good.

- (ii) **In advance of your meeting, prepare a note which sets out the options that are available to Mr Gadwall and the potential consequences of each option. (12 marks)**

This is a scenario that an IP could be expected to see on a day to day basis. Again the candidates who did well were those who considered the wider relevant options and considerations available to him, rather than simply equating options with 3 statutory debt solutions and regurgitating the differences between them. It is positive that almost all candidates were aware of DAS as an option and could comment meaningfully on how applicable it would be in this case.

- (iii) **Given your prior instruction by Mr Gadwall, explain whether or not it would be appropriate for you to accept appointment as his Trustee. (5 marks)**

There were a few really strong answers to this part of the question but on the whole candidate's comments were fairly limited.

- (iv) **Explain whether or not it would be commercially worthwhile for you to accept the appointment as Mr Gadwall's Trustee; (4 marks);**

The responses to this were interesting and it was clear that few candidates have made this assessment on a regular basis which is concerning since it would be their livelihood which would be affected.

- (v) **Having regard to the circumstances of Mr Gadwall's case, set out the sums that would be payable out of the estate ahead of any distribution to Mr Drake and other unsecured creditors; (5 marks); and**

It was possible to score very highly on this question which simply requires reference to the Act, together with some meaningful comment regarding how it applies to this case. Where it was answered this was answered well.

- (vi) Set out the various ways in which a Trustee can be appointed both in the specific circumstances of this case and generally; (4 marks).**

As for part (v) high marks could be scored relatively easily in this section which simply required reference to the relevant legislation. Again where it was answered, this was answered well.

## Question 2 (20 marks)

### Implications if the facility is not renewed

Upon the expiry of the facility, the brothers will be liable to repay the amount then outstanding to Rouen Bank.

Given that there is asset value of £3m to £3.9m outstanding against a required facility of £4.7m, it appears unlikely re-banking the facility with another bank will be a possibility.

Unless those brothers with assets are willing and able to inject capital to cover the shortfall.

If the brothers do not repay the facility when requested then under the terms of their security, the Bank will be able to call up their security and take possession of the properties.

Once in possession the Bank will collect the rental income generated by the properties and will look to sell the properties to repay the indebtedness to the Bank.

It is unclear whether a formal partnership agreement was entered into although the brothers have been trading in partnership, therefore appears to be a partnership at will. The brothers are therefore all jointly and severally liable for the shortfall to the Bank.

The Bank may have a preference to appoint a Trustee to the Partnership to avoid the Bank having to take possession of the properties. They could petition for the sequestration of the partnership on the basis of the unsecured sums due to them by the Partnership.

Assuming that the partnership is insolvent then the partnership (Trustee) would look to the individual partners to fund the shortfall.

The sale of the properties may give rise to a liability to CGT depending on the extent of the likely capital loss on the Mill which can be offset against the likely gain on the Rental Properties. The brothers will be liable individually for the CGT and would need to seek agreement from the bank that an allowance is made from the net sale proceeds for the CGT liability. If not, the brothers would need to raise sufficient funds to discharge the CGT liability.

Check whether partnership tax returns were filed and whether terminal loss relief might be available.

If one of the brothers discharges more than his proportionate share, he would have a claim against the other brothers. It appears that Barry will not be in a position to discharge his share of the indebtedness. Gary and Harry will be liable for any shortfall to the bank and are likely to be pursued by the Bank.

### Options available

Based on the current figures, there will be a shortfall to the Bank of between £800,000 to £1.7 million for which the brothers will be jointly and severally liable. It is therefore in the brothers' interest to ensure that realisations are maximised.

**Refinance** - Do any of the brothers have the means and appetite to cover this shortfall from the personal assets/property and investments. If so they could consider re-financing the current facility from Rouen either fully or with an alternative lender.

Assuming that there is no ability to refinance, it would be in the brothers' interests to agree a **consensual sale** strategy with the Bank. The brothers may want to consider marketing for sale some or all of the Rental Properties and/ or flats in the Mill in order to try and achieve the best possible price.

A consensual sale process will avoid the perception of a distressed sale and help to maximise values achieved.

Agents advice should be taken on whether a sale as a portfolio or a gradual exposure of the properties to the market for example, when the tenancies expire would be best.

Depending on agents advice it may be optimal to agree a budget for an element of renovation of the properties from the sales proceeds of previous units if this will improve realisations.

A consensual sale process will also avoid costs of litigation and for example a Trustee to manage the process and the ongoing property management and should limit the shortfall under the security.

Although the facility expires in just over 3 months, if a sale or sales have been agreed but has not completed at the end of February 2019, subject to agent's advice that the sale is at the best possible price, the Bank is likely to allow a sale to proceed.

If the properties are all tenanted advice should be taken from an agent regarding the property value and whether this would be maximised through selling the properties subject to the existing tenancies. Given the timescales available, it is unlikely that the brothers would have sufficient time to obtain vacant possession and effect a sale prior to February 2019.

A proposal for the consensual process should be made to Rouen Bank supported by agent's recommendations and setting a clear timescale for reporting progress. To retain the buy in of the Bank it would then be important to deliver on this plan.

If a consensual sales process is commenced, the Bank may be willing to agree to a short extension to the facility to allow the sales to proceed and the capital outstanding to be reduced.

Negotiations could be entered into with the Bank regarding the likely shortfall. The Bank may agree to an element of debt forgiveness. The brothers should consider what assets they have available and what could be offered to the Bank during negotiations once the shortfall is known.

Each brother is likely to enter their own independent negotiations with the Bank and they may be able to negotiate a fixed sum settlement or obtain a fixed term loan from the bank to repay an agreed share of the shortfall rather than the bank having to take action against them. Proactive negotiation is recommended in these circumstances.

Given their differing financial positions, the brothers may need to take their own independent advice regarding the shortfall. It would be unlikely that you would advise all of the brothers as they are likely to have claims against each other in the future if the bank ultimately pursues them in terms of joint and several liability

Once the shortfall to the bank has been crystallised, both the Partnership and all of the partners should consider whether an insolvency process, Trust Deed or Sequestration is necessary or appropriate. In an insolvency all available assets including the investments and overseas properties will have to be realised

For the two brothers who appear to be more asset rich a DAS may be an option if they are not insolvent but simply need time and protection to pay their creditors in full through income/staggered asset disposals.

Barry has no assets and a limited income. As such, a Trust Deed might not be appropriate.

Barry should also be aware that if a Trustee in sequestration considered that his gambling had contributed to his insolvency, and application for a BRO could be made.

There is also potential that Barry's Trustee could consider challenging the previous agreement he has reached with his wife on divorce.

### Question 3 (20 marks)

#### (a) Surplus income

Within 6 weeks of an Award of Sequestration, the Trustee must send to the Accountant in Bankruptcy their proposals for a DCO (Debtor Contribution Order).

The AIB will fix the DCO (which can be nil) and should be paid for a period of 48 months, unless the sequestration can be paid in full before then.

The full surplus income must be paid to the sequestration including where for example overtime or bonuses are paid for additional hours worked.

When fixing the DCO the AIB must use the Common Financial Tool, set by Regulation and currently the Common Financial Statement. This provides for the debtor to be fixed costs, for example mortgage/rent/Council Tax/utilities and then gives maximum allowances for discretionary spend such as food/phone based on the Household composition

Mr Eider would have the right to appeal to AIB within 14 days if he disagrees with the DCO and ultimately a further right of appeal to the Sheriff if he disagrees with the decision.

The information provided shows Mr Eider's monthly income and expenditure:-

Income –	17,000
Maintenance –	3,000
School Fees –	2,300
Mortgage	3,300
Pension –	3,000
Range Rover –	506
Surplus	4,000

On the simple facts of this case, it does appear that Mr Eider will be required to enter into a DCO.

As Mr Eider appears to be self-employed, provision for tax should be allowed when calculating his surplus income. This will be significant assuming that this is gross income of £17,000 per month and will probably eliminate the theoretical surplus.

There is no provision for basic costs of living including food, Council Tax, Utilities, phone or the running costs of a vehicle which would need to be considered and allowances given in accordance with the CFT.

Section 89 (5) of the BSA 2016 covers the debtor's obligation to pay aliment which includes the obligation to make payment of an allowance to a former partner or to pay Child Support Maintenance, although the amount need not be sufficient for compliance with a subsisting order or agreement. Reference could be made to the maintenance which the CSA would set based on Mr Eider's income to agree an alternative reasonable figure.

There is no need to make provision for arrears of maintenance as these will be a claim in the sequestration.

In relation to the School Fees, the existence of the Court Order prior to sequestration does not mean that this is an expense which must be allowed by AIB when setting the DCO. The default position is generally that school fees are not an allowable expense. Whether it is considered reasonable expenditure in this case will depend on the specific circumstances of the children. For example, if a child is in a key exam year, where moving them would have significant detriment to their education then the payment of school fees, possibly to allow completion of a school year would be looked on more sympathetically than for example, a primary aged child.

Mr Eider pays £3,300 a month on a property which he appears to live in alone as it is not clear how often he has his children staying with him. Paying such a significant amount each month is unlikely to be permitted

and is likely to be reduced to the amount required to rent a reasonable property in the area. Albeit in practice, AIB may allow this as it is a fixed payment which has to be made by debtor.

The Range Rover rental agreement. The agreement has 1 year left to run. Though a vehicle may be reasonably required to allow Mr Eider to travel to his employment, it is not reasonable to spend £500 a month leasing a car, and upon expiry of the lease agreement, the amount payable pursuant to the DCO will need to increase to take account of this sum now being available to Mr Eider. The lease agreement should be checked to see whether early termination without any penalty charges is possible.

£3,000 a month contributions to pension. AIB NfG point out that as it is a policy objective to protect approved pensions, it follows that pension contributions are allowable expenditure when calculating surplus income. The Trustee could challenge pension contributions if they were being made to a new scheme or the contribution was being increased. However, the fact that this is a continuing payment that has been in place for many years may be persuasive when AIB fix the DCO.

## **(b) The Property**

A Trustee is under a duty to realise a bankrupt's sole or principal residence within 3 years of the sequestration.

There is £300,000 of equity in the property. Given the level of creditor claims, this will need to be realised.

It is unclear who is living in the property, whether Mr Eider with or without his children or the former Mrs Eider. Either way the property will have to be realised though who resides there will have implications for the defences which can be raised by the Trustee, unless there are any exceptional circumstances these are unlikely to do any more than delay an action.

Unless Mr Eider can introduce a third party or finance to can purchase the Trustee's interest in the property, it will have to be realised through either a consensual sale or through an order for eviction being obtained by the Trustee.

Mr Eider can consider whether he can secure finance, potentially from his pension, to realise the equity in the property. Raising finance other than from the pension is likely to be challenging while he is an undischarged bankrupt and also due to affordability (see Income and Expenditure).

Mr Eider will need to consider whether attempting to refinance and retain the property is realistic in his circumstances.

Although an agreement has currently been reached with the secured lender regarding the mortgage arrears, Mr Eider should be aware that if he does not maintain repayments, then the secured lender could repossess and the Trustee could not prevent this.

## **(c) Liabilities**

Unless a bankrupt's discharge is suspended as a result of a failure to co-operate with his/ her trustee, a bankrupt will receive his/ her automatic discharge from bankruptcy on the first anniversary of the making of the bankruptcy order.

**Section 145** of BSA Debtor is discharged of all debts except 145 (3) (f) refers to any obligation to pay aliment or any periodical allowance payable on divorce so he will still have an obligation to make monthly payments under the court order once discharged. BUT

This does not include any sums which could be included in a claim. Therefore any arrears up to this point would be a claim and will be discharged.

Capital sum on divorce and costs would also be discharged.

It is possible that other creditors may be being prejudiced by the capital sum on divorce. Consider section 100 re recall of the award of a capital sum on divorce. The capital sum at £450,000 compared to other claims of c£106,000 will receive around 80% of funds available for distribution.

**(d) Pension**

Personal Pensions do not vest since the implementation of the Welfare Reform and Pensions Act. Assuming that the pension has been approved by the Inland Revenue it will not vest.

The case of *Horton v Henry* confirms that a bankrupt cannot be compelled to draw down on his pension. Given that Mr Eider is 44, this is unlikely to be an option in any event.

Mr Eider contributes a significant sum into his pension each month (£3,000). However, when considering whether pension contributions can be recoverable pursuant to Section 342A, the Court has to consider whether the contributions are excessive in view of the individual's circumstances when those contributions were made and also whether the debtor's creditors have been prejudiced.

Given Mr Eider's income and also the duration over which the contributions have been made, it is unlikely that the contributions could be recovered as excessive.

#### Question 4 (40 marks)

**(i) Profit and loss account**

**Note – 1 mark available for layout/format of P&L.**

**If a figure is incorrect with no workings, ½ given for its inclusion.**

Gadwall Poultry and Meats

Estimated profit and loss account for the year to 31 December 2018

Sales (1)	285,000
Cost of sales (meat)	(210,000)
Gross Profit	75,000
Overheads/ expenses	
10% general overheads	28,500
Rent	8,000
Rates	7,000
Wages - self	2,000
Wages - staff (3)	19,364
Utilities	4,800
Total costs	79,664
<b>Net profit / (loss)</b>	<b>(4,664)</b>

(1) 15,000 x 11 months = £165,000

45,000 x 1 month = £45,000

Total £210,000 of purchases from Mr Drake

Less 5% in respect of wasted meat (10,500) meat with cost of £199,500 is sold. This represents 70% of sales (GP% of 30%)

Sales =  $199500/70 \times 100 = £285,000$

(2) see first part of (1)

(3) 30 hours x £9 = £270. £270 x 52 weeks = £14,040

December 50% increase ( $£270/2 \times 4^*$ ) £540.00

10 hours x £5.60 = £56. £56 x 52 = £2,912

December 50% increase ( $£56/2 \times 4$ ) £112

Assume Employer's NIC say 10% £1,760

Total £19,364

\*assumes 4 weeks in December rather than 1 month

**(ii) Options available to Mr Gadwall and potential consequences**

The business is loss making. Even though a profit will be generated in December, this is not sufficient to cover the losses made in the first eleven months of the year.

It would make sense for the business to continue to trade until the end of the year as the estimated profit during December will cover the loss that is anticipated during November. The creditor position will not worsen.

Mr Gadwall is also balance sheet insolvent, the time available to look for a solution is limited.

Although the business is lossmaking, this is relatively marginal. Are there any steps which could be taken to improve the profitability of the business in the short term to allow Mr Gadwall more time to assess his options:-

Reduce wastage;

What is in overheads – high?

Increase prices;

Negotiate better prices with meat supplier

Reduce drawings.

Whilst Mr Gadwall could try and sell the business as a going concern, continuing to trade after Christmas will result in Mr Gadwall incurring further liabilities. In addition his current supplier has said that he will not continue to supply Mr Gadwall. As such Mr Gadwall does not have significant time to try and effect a sale.

If Mr Drake does stop supplying Mr Gadwall in January, he will either have to agree to start paying in cash or look for another supplier which may be more expensive

If Mr Gadwall takes no action, creditors, specifically Mr Drake could commence legal proceedings and / or present a bankruptcy petition. If he is made bankrupt Mr Gadwall will not be able to continue trading in any event.

Mr Gadwall could close the business and, given his limited assets, could try and reach an informal agreement with his creditors (Mr Drake) to include a surrender of the lease of the premises back to the landlord.

If the business could be returned to profit and just needs time to repay its debts then Business DAS with repayments being made from future income and a possible discretionary condition to make an initial repayment from cash savings could allow Mr Gadwall time and protection from creditors to repay his debt in full. If done through Business DAS then the maximum repayment term would be 5 years. It is particularly important to consider Mr Gadwell's age and the sustainability of repayments in the context of this solution.

If there is no future income stream from a profitable business then Mr Gadwall requires debt relief. The options would be to enter a Trust Deed or to apply for his bankruptcy. In either scenario, the Trustee would need to realise the cash (possibly subject to offset) and the van and equipment.

If the business was still trading the Trustee would deal with the employees, landlord and the creditors.

Enquiries should be made to establish whether Mr Gadwall has one lease in respect of both the flat and the shop. If he does, surrendering the lease would result in Mr Gadwall losing his home unless terms were agreed for Mr Gadwall to take a lease of just the flat going forward.

If Mr Gadwall wishes to avoid the perceived stigma of bankruptcy or if he wishes to act as a Director or on a School Board he may wish to avoid bankruptcy and pursue a Trust Deed.

### **(iii) Appointment (5 marks)**

An Insolvency Practitioner should comply with the Insolvency Code of Ethics.

Prior to taking an appointment an Insolvency Practitioner should take care to identify the existence of any threats which might reasonably be expected to arise during the course of the appointment.

The Insolvency Practitioner, should consider the extent and nature of any prior involvement with his Firm (Mr Gadwell had been referred by a colleague). Establish what if any previous work was done by your Firm.

The Insolvency Practitioner should also consider whether any threats have arisen given the previous instruction by Mr Gadwall.

The instruction was however limited to a review of his financial position and a discussion surrounding the options that were available to him.

Whilst a familiarity threat can occur when because of a close relationship, an individual could become too sympathetic to the interests of others, in this case, there is no ongoing relationship with Mr Gadwall here.

Self-review threat - as Mr Gadwall has died, the advice that was given to him whilst he was still trading was not acted upon is unlikely to impact upon your ability to administer his estate.

In the circumstances there does not appear to be any reason why the appointment could not be accepted.

**(iv) Commerciality of accepting appointment (4 marks)**

Mr Gadwall's assets have an estimated value of £17,200 to £22,200 (depending on whether Muscovy Bank can claim set off - see below).

There would be costs of realisation associated with realising the van and personal effects/ items in the shop.

In addition, set off may apply in respect of the overdraft and savings account with Muscovy Bank. If set off does apply, this would reduce the amount in the savings account to around £9,700.

There is also a risk that the overdraft increased/savings reduced in the period prior to Mr Gadwall's death. The balances should be confirmed with the Bank.

The landlord may have claimed hypothec over the goods in the shop if any arrears of rent have accrued

Subject to confirming the above, once the estimated costs of realising the assets (say 10% - £750) this could leave circa £16,500 to £21,500 to discharge the Trustee's disbursements and time costs.

If Mr Gadwall was registered for VAT, the VAT on professional fees could be reclaimed.

It appears to be a straightforward estate, with a few asset issues and 2 former employees. Predicted realisations though limited mean accepting the appointment could be justified although overall fees would be limited.

The reasonable funeral, testamentary and administrative expenses of Mr Gadwall's estate are payable in priority to preferential debts but not before the Trustee's remuneration.

**(v) Sums payable in priority to unsecured creditors (5 marks)**

Section 129 of BSA 2016 lays out the order of priority of distribution

- Outlays and remuneration of Interim Trustee – possibly relevant here if any requirement to take control of trading (if not already ceased);
- Outlays and remuneration of Trustee;
- Where the debtor has died – deathbed and funeral expenses . Notes for Guidance clarify that died in this context means deceased at the date of bankruptcy and therefore relevant here.
- Petitioning costs – Mr Drake if he takes this step.
- Ordinary preferred debts
- Secondary preferred debts

Preferred debts will include sums which will possibly be due to the employees either for wages or accrued holiday pay which will have a preferred ranking

And finally ordinary debts.

It is likely that there will be very limited funds available for distribution to the unsecured creditors, including Mr Drake

**(vi) appointment of a Trustee (4 marks)**

1. In the specific circumstances of this case, Application by Executor or person entitled to be an executor of a deceased's estate (BSA s5)

More generally, a Trustee can be appointed by:

2. Debtors application by the debtor after money advice, direct to the AIB with nomination of a Trustee – cost £200
3. Creditor petition by qualifying creditor (BSA 2016 s1) where sums due exceed £3,000 – through the relevant Sheriff Court
4. Petition by Trustee under a Trust Deed (BSA 2016 s1)
5. Appointment of a replacement Trustee at statutory creditors meeting (BSA 2016 s49)
6. Block Transfer on change of circumstances/death or retirement of Trustee by application to AIB (BSA 2016 s62)