

JOINT INSOLVENCY EXAMINATION BOARD

Joint Insolvency Examination (Scotland)

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Insolvency
Examination
Board*

9 November 2021

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

References to legislation are to that which was in force on 30 April 2021. References to ‘The Act’ are to the Insolvency Act 1986 as amended.

References to Sections, Schedules and Rules are to Sections and Schedules of the Act and to Rules of the Insolvency (Scotland) Rules 1986.

References to Sections and Rules of other Acts, Regulations and Orders will mention the Act, Regulation or Order.

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 **right arrow** in the header to begin the exam. The exam timer will begin to count down.
4. When the exam timer reaches zero, the exam will end. To end the exam earlier, navigate to the last question and click the right arrow button. Click the **Submit** button to close the exam.
5. You may use a pen and paper for draft workings. Any information you write on paper will not be read or marked.
6. You must make sure your answers and workings are clearly visible in the word processing area when you submit your exam. Only your answer in the word processing area will be marked. **You must copy over any data from the spreadsheet area to the word processing area for marking.** The examiner will not be able to expand rows or columns where content is **not** visible.

7. The examiner will take account of the way in which answers are structured. Respond directly to the exam question requirements. Do not include any content or opinion of a personal nature, this includes your name or any other identifying content. A student survey is provided post-exam for feedback purposes.

Question 1

You are an Authorised Insolvency Practitioner and have been contacted by Nick and his sister Holly, the Directors and equal Shareholders of Romilysur Ltd (“the Company”). The Company organised media trade fairs but has recently ceased trading. Nick and Holly have decided to take early retirement and have agreed that the Company should be wound up solvently. They would like you to be appointed as Liquidator and have prepared a draft Declaration of Solvency for you to review. Previously the Company employed an Accountant, but to save costs the Directors decided to prepare the Declaration of Solvency themselves.

Declaration of Solvency for Romilysur Limited as at 31 October 2021

Assets	£
Cash at bank	105,000
Debtors' ledger	90,000
Cash deposits	<u>5,600</u>
Estimated realisable value of assets	<u>200,600</u>
Liabilities	
Trade creditors	110,000
Estimated surplus after paying debts in full	<u><u>90,600</u></u>

At an initial meeting with Nick and Holly to discuss the Declaration of Solvency you find out the following information:

- The Company has settled all bank debt and has no securities or floating charges outstanding.
- 60% of the debtors, which are fully collectable, are factored to an invoice discounting company at an advance rate of 75%. There is a 3 month notice period to terminate the facility and the Company pays £2,000 per month plus VAT in charges. The remaining debtors relate to amounts invoiced to stall holders in advance of the relevant trade fair taking place.
- The Company has received cash deposits from stall holders totalling £5,600. These funds are currently in a safe in the Company's rented office. The terms and conditions of the contract with stall holders states that if a trade fair is cancelled then they will receive a full refund.
- Nick and Holly each drive a Land Rover Discovery which they each treat as their own vehicle for personal use. The cars were purchased by the Company on hire purchase finance. There is one year left on the finance deal and both Nick and Holly intend to keep the vehicles. The finance company has advised that if the Company would like to terminate the agreement early, the termination balance due would be £5,000 per car. The cars have been valued at £20,000 each.
- The Company has paid £20,000 in deposits to event venues. All bookings have been cancelled in time to qualify for a return of 75% of the deposits paid. No deposit refunds have yet been applied for.
- Three years ago, Holly borrowed £56,000 from the Company to fund her house extension. She put this money through her Director's loan account.
- The Directors have agreed to surrender the lease of the Company's rented office to the landlord. Since taking on the lease the Company has also used the space to experiment with various trade stall ideas and as a result the landlord has served a £35,000 dilapidations bill. There is no outstanding rent due.

- The trade creditor balance has been taken from the Company's books and records. One of the unpaid invoices, which totals £12,500, is only payable if a cancelled event space cannot be resold by the organiser.
- The Company is being pursued for compensation in relation to damage caused to a stall holder's demonstration vehicle at a motor show. The total claim is for £88,000. The Company has made a claim against their insurance which should be successful. The insurance excess is the greater of 12% of any claim or £9,000.
- The Company has a subsidiary called Miniromi Ltd ("Miniromi") which carries out the marketing for the trade fairs. Accounting between the two entities has always been quite relaxed. £7,600 of outstanding marketing invoices are due to Miniromi from the Company. The Company also provides management services to Miniromi for which it charges £750 per month. There were three months of charges outstanding when the Company ceased trading. None of these management services invoices has yet been raised.
- Tax returns have been completed up to cessation of trade and there are no liabilities due to, or amounts due from, HMRC. The Company remains registered for VAT.
- In all the circumstances, you believe that you will be in a position to pay a dividend to creditors 12 months after the Liquidation commences.

Requirement

- (a) Comment on the draft Declaration of Solvency, setting out any adjustments you would make. Prepare a revised calculation for your next meeting with the Directors, clearly stating any reasonable assumptions that you have made.**

(12 marks)

At the following meeting to discuss the possible liquidation, Holly revealed that, due to some bad investment decisions, she has no material assets, her house is in negative equity and therefore she is unable to repay the amount borrowed to fund her house extension.

Requirement

- (b) Set out the possible options to deal with this change of circumstances and explain the associated consequences for the Company and Holly.**

(8 marks)

Total: (20 marks)

Question 2

Requirements

State the practical and legal steps that you should take to address the following matters.

- (a) Your Firm has recently merged with a local competitor. You have identified several insolvency cases where the newly merged firm is now acting for different stakeholders. **(3 marks)**
- (b) You have recently received a bank transfer of £55,000 from a sole trader who is a debtor of a company of which you are Liquidator. The money was transferred from an Isle of Man bank account. The sole trader has now contacted you to explain that they have overpaid the amount due by £50,000 and has requested that you refund the money to a different company bank account held in Scotland. **(5 marks)**
- (c) The sales manager of a company where you act as Administrator has informed you that he is unable to locate an expensive company laptop that he had been using recently. **(8 marks)**
- (d) A company over which you have recently been appointed as an Insolvency Officeholder is part of a VAT group. **(4 marks)**

Total: (20 marks)

Question 3

You have been approached by Croker Bank plc ("the Bank") in relation to one of its clients, Chimney Garden Centre Limited ("the Company").

The Company, a garden centre and plant nursery, has recently reported average monthly losses of c. £25,000 and, due to its poor trading performance, the Company's relationship with the Bank has been placed into the Bank's business support department. The Bank has been unwilling to support the Company's requests for additional funding and in a recent meeting it suggested that the Company should seek funding elsewhere.

Following that meeting the Bank has received a fully funded proposal from the Company on the following terms:

- the Company will pay to the Bank the sum of £2.3 million in full and final settlement of all debts due to the Bank; and
- in return the Bank will release all security and personal guarantees.

The Bank must decide whether to accept this offer and has asked you to provide it with advice to assist its internal review process. It has provided you with the following information:

Recent Balance Sheet

	Notes	£'000
Assets		
Land and Buildings	1	1,400
Stock	2	2,000
Liabilities		
Bank overdraft	3	(750)
Trade creditors	4	(290)
HMRC	5	(75)
Bank loan	3	(3,500)
Net liabilities		<u>(1,215)</u>

Notes

1. Property

The property comprises 3 acres of land and the garden centre building and it has recently been valued by RICS regulated agents, as follows:

market value (existing use, open garden centre, 6 months marketing)	£1.8 million
market value (closed, 3 months marketing)	£1.0 million

The property was acquired by the Company shortly following its incorporation in 2010 for £1.0 million.

2. Stock

The balance sheet value of stock, at cost, comprises:

	£'000	Upper case value	Lower case value
Bought-in plants	400	60% of cost	50% of cost
Self-grown plants	600	50% of retail value	30% of retail value
Bought-in non-plant products	1,000	80% of cost	60% of cost
	<u>2,000</u>		

The valuation bases were provided by a reputable firm of agents and assume a rapid trade sale to another garden centre (lower case value) or as a going concern in its current location (upper case value).

The balance sheet value of the self-grown plants is calculated by taking the retail value of each item and assuming a gross margin of 60%.

The realisation percentages do not take account of stock that may be subject to reservation of title claims.

3. Bank

The Bank facilities comprise:

- a term Loan of £3.5 million secured by a standard security over the property; and
- an overdraft facility with a limit of £1.0 million secured by a Bond & Floating Charge. This facility varies throughout the year due to the seasonality of the business.

In addition to its standard security and floating charge over the Company's assets, two of the Company's Directors, Mr Lister and Mrs Hadley, have provided guarantees to the Bank, limited to £50,000 and £100,000 respectively.

The Bank is satisfied that Mr Lister could easily discharge any amount demanded under his guarantee but Mrs Hadley has recently entered into a Trust Deed ("TD"). The terms of the TD, which include Mrs Hadley's liability under the personal guarantee to the Bank, provide for a total dividend of 20p in the £ to be paid to creditors over a 4 year period.

4. Trade creditors

There are 3 suppliers which, between them, are owed £240,000 and which account for most of the debt. An analysis of trade creditors shows the following:

	Owed £'000	Stock cost	
		Plants £'000	Non-plant £'000
Supplier A	75	25	25
Supplier B	125	100	-
Supplier C	40	15	15
Others	50	260	960
	<u>290</u>	<u>400</u>	<u>1,000</u>

As it is easy to identify the non-plant stock, all suppliers have valid reservation of title claims against these items. In relation to the bought-in plants, a review has indicated that only Supplier B is likely to have a valid reservation of title claim and then over only 50% of the stock supplied.

5. HMRC

This balance represents outstanding PAYE.

Requirements

- (a) To assist the Bank in its decision as to whether to accept the offer, calculate and set out the upper case and lower case values that the Bank should expect to recover if the Company was to enter Administration. (16 marks)
- (b) Summarise the key issues and risks in relation to achieving a sale of this particular business as a going concern. (4 marks)

Total: (20 marks)

Notes

Assume a corporation tax rate of 20%.

Ignore cost indexation in relation to the property.

Ignore VAT.

Question 4

In September 2021 you, an Authorised Insolvency Practitioner, were approached by a creditor of Pictus Bearings Limited (“the Company”), who had received notice that the Company was to be placed into Creditors’ Voluntary Liquidation. The creditor was dissatisfied with the Directors’ proposed choice of Liquidator and asked if you would be willing to act in such a capacity. As a result you were appointed Liquidator of the Company following meetings of Members and Creditors on 13 October 2021.

A statement of affairs was provided to Creditors at their meeting as well as a Directors’ report; however, the latter contained very little information. The statement of affairs is set out below together with notes derived from a meeting with the Directors.

	Book value as at 13 October 2021 £	Estimated to realise £	Notes
Assets subject to a standard security			
Land and property	500,000	800,000	1
Amounts due to Coral Property Finance plc	<u>(600,000)</u>	<u>(600,000)</u>	
	(100,000)	200,000	
Assets subject to a floating charge			
Cash at bank	30,000	30,000	
Stock	185,000	135,000	2
Trade debtors	250,000	200,000	3
Insurance claim	<u>-</u>	<u>50,000</u>	4
	365,000	615,000	
Preferential creditors			
Employees - arrears of wages		(25,000)	
Employees - holiday pay		(40,000)	
HMRC		(150,000)	
Net property		400,000	
Prescribed part carried down		<u>(83,000)</u>	
Amounts available for floating chargeholder		317,000	
Amount due to Mr Fish		<u>(350,000)</u>	5
Deficit to floating chargeholder		(33,000)	
Prescribed part brought down		83,000	
Unsecured creditors			
Trade creditors		(400,000)	
Landlord		(150,000)	6
Employees		(200,000)	7
Estimated deficiency as regards non-preferential creditors		<u>(700,000)</u>	
Issued and called up share capital			8
Ordinary A shareholders		(100)	
Ordinary B shareholders		(2,000)	
Estimated deficiency as regards members		<u><u>(702,100)</u></u>	9

Notes

1. The heritable property was bought many years ago and the estimated to realise figure is based on a valuation obtained by Coral Property Finance plc in 2020, shortly before it renewed the loan facility.
2. The stock is of good quality and is expected to realise 90% of its book value. An additional reduction has been applied to the book value due to a reservation of title claim from Cichlid Limited ("Cichlid"). Cichlid's claim, which is included in trade creditors, has also been reduced by this amount.
3. The Directors expect there to be some issues regarding the recovery of the book debts and have made a provision of £50,000 for potential bad debts.
4. There is an outstanding insurance balance due to the Company relating to a loss of profit business interruption claim, following a small isolated fire in 2020.
5. You have been able to determine that Mr Fish is a local businessman who, in December 2020, provided a 3 year loan to the Company. The amount currently owed to Mr Fish, as shown in the statement of affairs, includes a termination charge of £50,000 for ending the agreement early. Otherwise, you have been unable to find out anything more about this loan and the Directors were evasive when asked for further details.
6. The landlord liability relates to a separate leased production facility and consists of £50,000 rent arrears and the Directors' estimate of the landlord's claim resulting from a termination of the lease.
7. Employee claims include an estimate of £100,000 for redundancy costs, £75,000 for pay in lieu of notice with the balance comprising non-preferential arrears of pay.
8. In March 2021 the Company created and issued 200,000 new 1p shares (Ordinary B) to a new investor at a premium of 50p per share. The Directors have informed you that in May 2021 the Company declared and paid a dividend to both classes of share amounting to 10p per share.
9. The most recent set of statutory accounts showed the following capital and reserves position:

	Dec 2020
	£
Capital and reserves	
Ordinary A Shares (1p each)	100
Profit and loss reserves	150,000
	<u>150,100</u>

Requirements

- (a) Set out a deficiency account, reconciling the December 2020 position to that shown by the statement of affairs as at 13 October 2021.**
(7 marks)
- (b) Explain the purpose of the deficiency account and the reconciliation adjustments contained within your answer to Requirement 4(a).**
(5 marks)
- (c) In relation to the loan provided by Mr Fish and its associated security, explain what matters you would need to consider in relation to its validity and provide a list of information you would seek in this respect.**
(10 marks)
- (d) For each of the categories of assets shown in the statement of affairs, set out the steps you would have taken in the first two days following your appointment to preserve and/or protect their realisable value.**
(10 marks)

Last week you received information regarding Cichlid's reservation of title claim which relates to goods supplied several weeks prior to the Company ceasing to trade. You have established that, as a consequence of non-

payment of the associated invoices, prior to your appointment Cichlid had attended site and placed labels on the items to clearly identify those that it claims belong to it. These items were then set aside by the Directors and remain unsold.

You have been provided with a copy of the relevant terms and conditions of sale and are satisfied that these contain an 'all monies' clause and have been incorporated into the contract of sale.

Requirement

- (e) **Set out the information you would now seek to establish the validity of Cichlid's reservation of title claim and explain why, in these circumstances, this is required and/or relevant.** (8 marks)

Total (40 marks)

Note

Ignore VAT and corporation tax.