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Insolvency financial reporting

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Yvonne Joyce BA Hons CA

Senior Lecturer in Accountancy, Glasgow University

- Graduated from the University of Strathclyde with a first-class Honours degree in Accounting and Economics
- Commenced her professional accountancy training with Arthur Andersen, qualifying as CA with ICAS in 2000.
- Based in audit and assurance and corporate restructuring, involved in business reviews and formal insolvency appointments.
- Moved to a lecturing post within ICAS's Education Department in 2002 and then to Strathclyde University in 2006.
- Joined the Accounting and Finance subject group at Glasgow University in 2011.
- Currently sits on the ICAS Insolvency Committee and the ICAS Academic Panel.
- Accounting Cluster Lead at Glasgow University.



Eileen Maclean MA (Hons) MIPA MABRP MBA

Director of Insolvency Support Services

- Licensed insolvency practitioner with over 30 years' experience of all aspects of Scottish personal and UK corporate insolvency.
- Founding director of Insolvency Support Services, an award-winning provider of a uniquely complete range of training, outsourcing, compliance and practice support services to the UK insolvency market.
- Specialises in complex issues and dispute resolution, and excels in compliance and training.
- Licensed by the IPA and a member of R3, Eileen represented Scotland on R3's National Council for six years, is an active member of R3's Scottish Technical Committee and represents Scotland on the IPA's Standards, Ethics & Regulatory Liaison Committee.
- Represents the IPA and R3 on the AiB's PTD Standing Committee, Bankruptcy Stakeholder Group and the Scottish Statutory Debt Solutions Discussion Forum chaired by Jamie Hepburn MSP, Minister for Business, Fair Work and Skills.



The research project

- Empirical focus is on **administrations**
- The research aims to contribute to the literature that explores the relationships between realisations, costs and returns to creditors
- Data set comprises all administrations of Scottish registered companies, which entered administration between **2012 and 2013**
- **282 companies in the population**
- **35 different IP firms**
- IPs authorised by a number of the RPBs, including **ICAS, ICAEW, IPA**
- Most of the data was gathered from the Administrator's statement of proposal, subsequent and final progress reports, and in particular the abstracts of receipts and payments (R&Ps)
- Acknowledge help and support provided by **ICAS and Insolvency Support Services**

Summary of reporting issues – 37% of cases have at least one ‘reporting issue’

Reporting issue	Number of times recorded in data set	% of total reporting issues
Accounting errors/ inconsistencies within and/or across abstracts of receipts and payments (R&Ps)	38	30%
No split or unclear split of realizations and/ or costs between fixed charge and floating charge assets	27	21%
Documents not filed at Companies House or missing Appendices, info, etc within reports	24	19%
Confusing/ inconsistent information provided in narrative of administrator’s proposal and progress reports	20	16%
Inconsistencies and/or unclear narrative surrounding stated statutory objective	10	8%
Missing period of account between administration and CVL and/ or closing balance from administration R&P not equal to opening liquidation figure (funds transferred in)	8	6%



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Allocating receipts and payments between fixed charge assets and floating charge assets

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Allocating receipts and payments between fixed charge assets and floating charge assets

- Splitting the realisations and costs between fixed charge assets and floating charge assets
- In a number of cases, this simply was not clear
- For example, R&Ps did not clearly state what were fixed charge realisations, with a corresponding list of costs associated with fixed charge realisations and what were floating charge asset realisations, with a corresponding list of costs associated with realising these assets
- The user is left to ‘figure it out’
- Zero costs allocated to realising fixed charge assets
- Overall, it can be very difficult to understand the nature of security arrangements in a particular case and therefore how the asset realisations have been allocated.



SIP 14: A receiver's responsibility to preferential creditors

- SIP summarises best practice to be adopted by receivers of assets of companies subject to a floating charge so that the receiver has legal obligations to creditors whose debts are preferential
- Whilst SIP “does not specifically address the treatment of preferential claims in liquidations, but members acting as liquidators (or in any other relevant capacity) should have due regard to the principles which it contains”



SIP 14: purpose

- creditors whose debts are preferential may be concerned about the categorisation of assets as between fixed and floating charges and the manner in which costs incurred during a receivership are charged against the different categories of assets.



SIP 14: categorisation of assets and allocation of proceeds

- In order to ascertain what assets are subject to the statutory rights of creditors whose debts are preferential,
- it is necessary to distinguish, on a proper interpretation of the charging document(s), which assets are subject to a fixed charge and which are subject to a floating charge.
- Scotland: necessary to confirm which assets are subject to a standard or other fixed charge and which are subject to a floating charge



SIP 14: categorisation of assets and allocation of proceeds

- When assets are sold as part of a going concern (or otherwise in parcels comprising both fixed and floating charge assets)
- the apportionment of the total consideration suggested by the purchaser (for example for his own financial reasons) may not properly reflect the financial interests of the different classes of creditors in the individual assets or categories of assets.
- In these circumstances the receiver should ensure that he will be able properly to discharge his obligations to account to holders of fixed charges on the one hand and creditors interested in assets subject to floating charges on the other.



SIP 14: apportionment of costs

- The amount available to meet preferential debts is the funds realised from the disposal of assets subject to a floating charge net of the costs of realisation.
- It is dependent, therefore, not only on the correct categorisation of the assets but also on the appropriate allocation of costs incurred in effecting realisations.
- Three categories:
 - Liabilities incurred by the company
 - Costs of the receiver
 - Remuneration and disbursements of receiver



SIP 14: apportionment of costs

- Liabilities incurred by the company and the receiver's reasonable costs are sometimes readily identifiable as applicable to either the fixed charge or floating charge assets, but in other cases may not be so easily allocated between the two categories of assets.
- Where costs are clearly identifiable as having been incurred in the realisation or collecting in of one or other of the two categories they should be recorded as such in the receiver's records so that they can be deducted from realisation proceeds in ascertaining the amount available for each class of creditors.



SIP 14: Trading

- In trading scenario, may be difficult to arrive at an appropriate allocation of costs.
- Many of the trading activities will enhance the realisations of assets in both of the categories identified above.
- These factors do not affect the duty of a receiver to allocate costs appropriately but that allocation will involve the exercise of professional judgement undertaken with a full appreciation that it must be made with independence of mind and with integrity.



SIP 14/SIP 9 requirement to keep time records

- In order to enable a receiver to allocate costs on an appropriate basis,
- contemporaneous records of the dominant reasons for incurring costs should be maintained.
- These will also assist him in providing explanations as to how he arrived at what he considers to be an appropriate allocation and provide evidence should that allocation be challenged by any of the parties involved.



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Receipts and Payments accounts: arithmetical issues and presentation

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Receipts and Payments accounts: arithmetical issues and presentation

- Taking into account distributions to the secured creditor, in some cases, the arithmetic **does not 'add up'**
- Fixed charge realisations less associated costs less distributions to the secured creditor = a negative figure
- Intuitively, this suggests an **'overpayment'** from available net assets to the secured creditor
- 'Final' R&Ps showing a **'positive' net receipts figure** instead of nil
 - How will these funds be applied?
 - Further distributions to creditors? Which ones?
 - Further payment of office holder fees?



Receipts and Payments accounts: arithmetical issues and presentation

- Administration and CVL cases
 - It can be difficult to build a complete financial picture
 - Usually the **final balance on the administrator's R&P** does not coincide with the **opening figure/ funds transferred in on the first set of liquidation accounts**
 - There is no accompanying narrative attached to the administration or the liquidation accounts which might explain why these two figures differ
- Some 'housekeeping' issues were observed
 - Top half of the R&P (net receipts and payments) \neq bottom half of the R&P (represented by)
 - Addition/ arithmetical errors



SIP 7: Preparation of Financial Information in Insolvency Proceedings

- IP reports regularly to creditors and other interested parties
- Reports should be clear and informative
- Bear interests of reader in mind
- Present what is appropriate or significant in circumstances of case
- OH should report in a way that will assist creditors and other interested parties properly to exercise their rights under the insolvency legislation



SIP 7: Form and general presentation of accounts

- Information provided may be in a separate document issued with the R&P or given by way of note
- Show categories of items under headings appropriate for case where practicable using headings in Statements of Affairs or Estimated Outcome Statement.
- Or provide an analysis to enable comparison with 'estimated to realise' figures in any prior document



SIP 7: Payments to IPs and Associates

- Following should be disclosed (separately or by note):
- OH remuneration showing amounts paid, on each which basis
- Amounts paid re OH's pre-appointment costs
- Costs of supervision of trade
- All other amounts that require approval in same manner as remuneration



SIP 7: Payments to IPs and Associates

- Amounts paid to sub-contractors for work that would otherwise have to be carried out by OH or staff
- Remuneration or disbursements paid to OH other than out of the estate, giving amounts paid, name of payer, relationship to insolvent estate and nature of payment
- Disclosures should be made whenever reporting on remuneration and/or expenses
- Whether incurred, accrued or paid



SIP 7: Requests for additional information

- Creditors and interested parties have right to seek further information about payments made by OH
- Extend to general expenses of administering estate as well as OH remuneration and disbursements
- Right to apply to court if costs excessive
- OH must provide sufficient information to enable creditors to consider whether to exercise rights
- Take adequate steps to bring rights of creditors and other interested parties to attention
- Put in report information on how they can access a suitable explanatory note



SIP7: Receipts

- Realisations by or on behalf of OH should be shown gross (i.e. before the deduction of costs of realisation)
- The costs of realisation should be shown separately as payments



SIP 7: Payments

- Payments should be stated by category distinguishing payments made under duress, in settlement of reservation of title claims, to secured creditors, to preferential creditors, and to unsecured creditors.
- The dates of payments to creditors ranking in the insolvency and the amount (pence in the £) should be stated.



SIP 7: Trading under office holder's control

- A separate trading R&P should be provided
- the balance result of that account trading should be shown as a single item in the main receipts and payments account.
- By note or report provide details of :
 - Assets in existence on appointment (Stock/WIP) and used in trading
 - Any uncollected debts and unpaid liabilities
 - Trading assets still to be realised



SIP 7: Statement of Funds Held

- Disclosure should be made where the balance of the funds is held, distinguishing between:
 - Non-interest bearing account and
 - interest bearing account
 - Treasury bills
 - Other investments etc.



Practical quality controls

- Previous set of R&P to be attached to current draft so that reviewer can see carry forward figures match
- Attach relevant bank statement(s) with reconciliation, demonstrating funds in hand are matched by funds at bank
- Accounts reviewed in detail behind R&P for an obvious mis-postings
- Shortfalls due to secured creditors carried to next appropriate category of debt
- Group position clearly articulated in proposals, and then in R&P



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The statutory objective

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The statutory objective

- There are three to choose from:
 - a) rescuing the Company as a going concern;
 - b) Achieving a better result for the Company's creditors as a whole than would be likely if the Company were wound up (without first being in administration); or
 - c) Realising property in order to make a distribution to one or more secured or preferential creditors
- The administrator's proposal should make it clear which **ONE** is being pursued and why
- There should be a natural progression from the 'background/events leading up to administration' section of the administrator's proposal and the chosen statutory objective
- **48% of cases in the population pursued statutory objective c)**
- **78% of cases in the population were asset sales or dissolution with no or minimal assets**



Priority of objectives (p3 (3) & (4) Sch B1)

Must seek objective (a) unless either:

- a) Not reasonably practicable to achieve that objective, or
- b) Objective (b) would achieve a better result for the company's creditors as a whole

May seek objective (c) only if:

- a) Not reasonably practical to achieve either of objectives (a) or (b), and
- b) Does not unnecessarily harm interests of creditors as a whole



Administrator's Proposals (Rule 3.35)

- (1)(d) an account of the circumstances giving rise to the administrator's appointment
- (1)(f) if a statement of affairs has been submitted, a copy or summary of it and any comments which the administrator may have upon the statement of affairs
- (1)(h) if no statement of affairs has been submitted, the details of the financial position of the company at the latest practicable date and an explanation as to why no statement of affairs
- (1)(j) a statement of how it is envisaged the purpose of the administration will be achieved



Substantial change to proposals

(p54 Sch B1)

- If, after proposals approved, administrator proposes changes which he/she thinks substantial, administrator required to
 - send revised proposals
 - Seek a decision from creditors
- May approve with/without modifications



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**The level of
indebtedness – how
much are creditors
owed?**

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The level of indebtedness – how much are creditors owed?

- Establishing the level of indebtedness of the company provides useful information on likely and actual creditor dividends
- Reporting secured debt where cross-guarantees are in place



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Conclusion and Recommendations

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In conclusion

- Insolvency reports should provide a **clear and unambiguous account** of how the office holder has discharged their statutory duties
- Put simply:
 - How much cash was realised and from what assets?
 - How much cash was paid out?
 - What were the big items of expenditure?
 - What was owed to the different categories of creditors?
 - How does this translate into creditor dividends paid out?
- The Insolvency Practitioner is the **‘knowledge expert’**
- He/she should seek to **reduce the ‘information gap’** between themselves and the body of creditors



Recommendations

- Application to SIP 14 to all corporate insolvency proceedings
- Improving content of proposals – explain and justify administrator’s statutory objective, particularly if chosen in preference to liquidation
- Attention to detail
- Cold read by independent reviewer reading from creditor perspective
- Reminder about Insolvency Code of Ethics and principles of transparency, objectivity and professional standards and competence



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Questions

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Thank you for listening

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