INSOLVENCY

DEFINITION

Insolvency is the situation where an entity cannot raise enough cash to meet its obligations, or to pay debts as they become due for payment. In legal terminology, the situation where the liabilities of a person or firm exceed its assets. In practice, however Properly called technical insolvency, it may occur even when the value of an entity's total assets exceeds its total liabilities.

MEANING OF INSOLVENCY

According to law, a person cannot be called an insolvent simply because he is unable to meet his liabilities fully. He can be considered an insolvent only when he has been adjudicated (declared) insolvent by a court. An insolvent is a person whose liabilities exceed his assets and who has been adjudicated insolvent by court .

Distinguish between balance sheet and statement of affairs.

The main differences between a statement of affairs and balance sheet are as follows:

a) The balance sheet of an individual or a partnership firm is not regulated by any act, where as statement of affairs of an individual or a partnership firm is regulated by the Insolvency Act. (b)A balance sheet is usually prepared at the end of each accounting year, whereas a statement of affairs is prepared on the date on which the order of adjudication is passed against the debtor. (c) A balance sheet shows the assets and liabilities as well as the capital of the person . But a statement of affairs shows merely the assets and liabilities of a person but not his capital. (d) .A balance sheet includes even fictitious assets, i.e., assets which are not realizable, whereas a statement of affairs does not include fictitious assets.

Deficiency Account

A Deficiency Account is the second statement submitted by an insolvent to the court on the passing of adjudication order. It explains how the deficiency, as shown in the statement of affairs under list H, has been brought about.

Distinguish between Provincial and Presidency towns

* The Presidency Insolvency Act of 1909 applies only to

Presidency towns of Kolkata, Mumbai and Chennai, where as Provincial Insolvency Act of 1920 applies to the rest of India. * The amount fixed as preferential creditors differ in these two Acts. * The official appointed by the court under the Presidency Towns insolvency act to realize the assets of the insolvent debtor to pay off his liabilities is called the " official assignee". whereas the official appointed by the court under the Provincial Insolvency Act to realize the assets of the insolvent debtor and to pay off his liabilities is called the "official receiver" .

Preferential creditors according to Insolvency Act

Preferential creditors as per list D refer to those unsecured creditors, who, because of provisions in the insolvency act, have priority over the other unsecured creditors. They are paid in full, if the property of the insolvent is sufficient.

Ex: all debts due to the government or local authorities, salary due to clerk, wages due to workers, rent etc.(as per the limits specified in the act).

Doctrine of reputed ownership

According to this doctrine, if the insolvent carries on business with goods belonging to others, but, in his possession with their consent, under such circumstances as to be able to infer that he himself to be the true owner, such goods can be taken to be the property of the insolvent for the purpose of distribution amongst the creditors. The doctrine however does not apply to:

(a) Immovable property (b) goods in possession of the insolvent as repairer or carrier and (c) goods in possession of the insolvent as the trustee.

list A in insolvency.

List A consists of unsecured creditors. It includes all those liabilities of the insolvent, which we have no security. Ex: sundry creditors, bills payable, bank overdraft not covered by securities, loans not covered by any securities and amounts payable on contingent liabilities likely to be dishonored, non-preferential amounts due for salaries, wages and rent.

Property not available for Distribution.

Property held by the insolvent in his capacity as a trustee or bailee or the fiduciary capacity is not available for distribution amongst the insolvent creditors. Similarly, under the Presidency Towns Insolvency Act trade tools of the insolvent, wearing apparels, cooking utensils, bedding and furniture not exceeding Rs 300 under in value, are not available for distribution . The same is true of pension, gratuity and provident fund received by an insolvent person.

Fraudulent preference

When an insolvent debtor transfers property or pays a particular creditor in preference to another creditor, more than what he could have got had the insolvent's assets been proportionately distributed amongst all the creditors, he is deemed to have shown fraudulent preference in favors of a particular creditor. Fraudulent preference being void in the eyes law, the creditor who has been shown preference has to return the property or money when an order of adjudication is passed against the insolvent.

Voluntary transfer

Voluntary transfer of property is said to take place when a person transfers it to another without consideration. If he insolvent has voluntarily transferred his property to another without consideration, during two years preceding the date of order of adjudication, the same is void under the Presidency Towns Insolvency Act. However, such a transfer is voidable as against the Official Receiver in the case of Provincial Towns Insolvency act.

Voluntary transfer made by an insolvent will not be void in the following cases:

(a)when it is made in consideration of marriage. (b)When it is made in favors of a purchaser in good faith and valuable consideration.

Provisions of the Insolvency act with regard to Interest.

Creditors can claim interest on their debt upto date of the order of adjudication. If the property of the debtor is sufficient to make the payment of creditors in full and a interest will be paid to the creditors for the period after the order of adjudication at the rate of 6% per annum.

Doctrine of Relation Back

Under the presidency towns insolvency act, the order of adjudication relates back to the first available act of insolvency and under the provincial insolvency act it relates back to the date of presentation of the petition of insolvency. This doctrine is known a Doctrine of Relation Back. So the insolvency of a person commences not from the date when the order of adjudication is passed but from an earlier date.

Act of insolvency.

A debtor commits an act of insolvency if he makes a transfer of his property or part thereof with intent to defeat or delay his creditors, he departs or remains out of the territories to which this act extends, absent himself, he secludes himself so as to deprive his creditors of the means of communicating with him etc.

Insolvency procedure

Petition for adjudication as insolvent may be presented either by the debtor or creditor in a court. When the order of adjudication is passed, the whole property of the insolvent shall vest in the court and shall become divisible among the creditors. Then the Order of Discharge is passed. On obtaining the order of discharge, the insolvent becomes a free man once again.

Treatment of the Ornaments for wife out of drawings in Insolvency Accounts

When the debtor makes drawings and out of these drawings his wife’s ornament are made, later on his wife gives these ornaments to her husband-debtor for payment of his liabilities, in such a case any one of the following methods may be used:

The face value of these ornaments is recorded in the inner column (book value) and the Realizable value in the outer column in list E. Difference of face value and realizable value of ornaments is shown in Deficiency Account and the face value of ornaments is deducted from drawings and the reduced drawings are shown in Deficiency Account.

Record the realizable value in List E in Statement of Affairs. In the Deficiency Account only the realizable value of the ornaments is shown on the left hand side. No deductions are made out of the drawings.

Treatment of Loan from wife.

If the insolvent's wife has given loan out of her personal property ' stridhan' or her self-earned income, the loan is included in creditors (List A). If the loan has been given out of the money given to her by the husband(insolvent), then her postion is not at par with the creditors. The amount contributed in such a case is taken as the capital of the Proprietor (insolvent)

Treatment of Reserve for bad and doubtful debt .

It is recorded in the left hand side of deficiency account because it is a part of profit.