

# **Idhaya College for Women Kumbakonam**



**PG & Research Department of Commerce**

**I BCom**

**Business Accounting - 16CCCCM3**

**Unit – V**

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## **Unit – V**

### **INSOLVENCY ACCOUNTS**

#### **Meaning**

Insolvency is a term for when an individual or organization can no longer meet its financial obligations to its lenders as debts become due. Before an insolvent company or person gets involved in insolvency proceedings, it will likely be involved in informal arrangements with creditors, such as setting up alternative payment arrangements. Insolvency can arise from poor cash management, a reduction in cash inflow, or an increase in expenses.

#### **Definition**

“A person is said to be insolvent who has ceased to pay his debts as they become due, whether he has committed an act of insolvent or not” -Indian sale goods act in sec 2(8)

#### **Format of Statement of Affairs**

**The Statement of Affairs is prepared in the following manner:**

A number of separate lists, called List A to H, are prepared and attached to the Statement of Affairs given above. A Statement of Affairs, like a Balance Sheet, is divided into two parts.  
Left-

hand side of the Statement of Affairs is liability and right-hand side of the Statement is assets.

**STATEMENTS OF AFFAIRS**  
(as required by the Indian Insolvency Act)

**IN THE COURT OF JUSTICE**  
**In Insolvency**

To the Insolvent:

You are required to fill up carefully and accurately, this sheet and several sheets A, B, C, D, E, F, G and H, showing the state of your affairs on the day on which the order of adjudication was made against you, viz. the.....day of .....20.....

Such sheets, when filled up, will constitute your Schedule and must be verified by Oath or Declaration.

Gross Liabilities	Liabilities (As stated and estimated by the Debtor)	Expected to Rank	Assets (As stated and estimated by the Debtor)	Estimated to produce
Rs.		Rs.		Rs.
—	Unsecured Creditors as— per List A		Property as per List E, viz:	
—	Fully Secured Creditors as per List B		(a) Cash at Bank	
	<i>Less:</i> Estimated value of Securities		(b) Cash in hand	
	Surplus:		(c) Cash deposited with solicitor for cost of petition	
	<i>Less:</i> Amount thereof carried to List C		(d) Stock-in-trade	—
	Balance thereof to contra		(e) Machinery	
—	Partly Secured Creditors as per List C		(f) Trade fixtures, fittings, utensils etc.	
	<i>Less:</i> Estimated value of Securities	—	(g) Furniture	
	Preferential Creditors as per List D (Creditors for Rent, Taxes, Salaries, Wages etc. payable in full Deducted as per contra..		(h) Life Policies	
			(i) Other properties	
			Book Debts as per List F, viz.	
			Good	
			Doubtful	
			Bad	
			Estimated to produce	—
			Bill of Exchange or other similar securities on hand as per List G	—
			Estimated to produce	
			Surplus from securities in the hands of creditors fully secured (per contra)	—
			<i>Deduct:</i> Creditors for preferential rent, rates, taxes, wages etc. (per contra)	
			DEFICIENCY as explained in List H	—

I/We \_\_\_\_\_ make oath, solemnly affirm, and say, that the above statement and the several lists hereunto annexed, A, B, C, D, E, F, G and H are, to the best of my/our knowledge and belief, a full and complete statement of my/our affairs on the date of the abovementioned order of adjudication made against me/us.

The explanation of each List is given below:

**1. List A-Unsecured Creditors as per List A:**

This list includes all Creditors, who do not possess any security of the Insolvent Debtor. That is, the Creditors without security fall under this list.

**Some of such Creditors are:**

Trade Creditors without security

Loan Creditors without security

Bank Overdraft unsecured

Bills Payable and Promissory Notes

Bills Receivable discounted likely to be dishonoured

Salary, Wages, Rent etc. over Preferential limit.

**2. List B-Fully Secured Creditors:**

This list includes all the Creditors, who have a claim against the debtor and have obtained a lien, guarantee or possession of some deeds or other securities. That is, the creditors, who have sufficient securities of the insolvent Debtor to meet their claims. The value of the securities may be equal to or more than the amount of their claims.

If there is any surplus of securities in the hands of fully secured creditors, such surplus will be shown on the asset side of the Statement of Affairs and will be available for distribution among the unsecured Creditors.

For instance, if a loan of Rs 10,000 has been taken on a security worth Rs 15,000, this loan is fully secured. The Surplus of Rs. 5,000 (Rs. 15,000-10,000) is shown on the asset side of the Statement of Affairs.

**3. List C-Partly Secured Creditors:**

There are certain Creditors, who have the security for a lesser value than the amount of their claims. That is, the Creditors of this type got only partial security for the loan advanced by them.

The securities are insufficient to meet the claims.

For instance, a loan of Rs 10,000 has been taken and the security for this loan is only Rs. 6,000. So, the loan is partly secured. The value of the security is not sufficient to cover their claims fully. The excess of loan over the security is shown in the outer column.

**4. List D-Preferential Creditors:**

This list shows the Preferential Creditors, who are entitled to priority over other debts of the insolvent. For instance, taxes, rates, wages, salaries etc. are paid in full.

**The following is the details of Preferential Creditors under the Presidency Towns Insolvency Act and Provincial Insolvency Act:**

	Type of Creditors	Presidency Towns Insolvency Act (Sec. 46)	Provincial Insolvency Act (Sec 61)
1.	Amount due to Govt. or any local authority—taxes, rates etc.	Full	Full
2.	Salary	Salary of 4 months before the date of the presentation of the insolvency petition, not exceeding Rs. 300 for each clerk	Salary, not exceeding Rs. 20 per head, in respect of services rendered during four months before the presentation of the petition
3.	Wages	Only 4 months or Rs. 100 whichever is less.	Rs. 20 per head
4.	Rent	One month rent. No limit to the amount	Nil

The amounts of the Preferential Creditors, who are paid in full, are shown in the inner column and this amount is to be deducted from the available assets.

The amount of salaries or wages or rent, in excess over the limit prescribed by the law, shall be included in the list of Unsecured Creditors under List A. All the above four lists, A to D, are shown in liability side of the Statement of Affairs.

**The following are the lists shown in the asset side of the Statement of Affairs:**

**5. List E-Properties:**

This is a list which includes all the assets of the Insolvent, except Book Debts, Bills Receivable and assets which have not been given as security to Creditors. Here all the assets-unencumbered properties i.e., free assets are shown. For instance, Cash in hand, Cash at Bank, Furniture, Machinery etc. Both book value and realisation value are shown.

**6. List F-Book Debts:**

All the debtors of the insolvent are shown in this list. Good, Doubtful and Bad debts are shown separately.

**7. List G—Bills of Exchange etc.:**

This list contains the information about Bills Receivable and Promissory Notes. The book value and the realizable value are shown separately.

## **8. List H-Deficiency Account:**

This list shows the deficiency i.e., liabilities of the Debtors over realizable value of his assets. For this purpose a separate Deficiency Account is prepared. Now, after writing the Lists E, F and G, the surplus, as per List B, appears on the liability side, is added to the assets. From this amount, the Preferential Creditors as per List D are deducted. The balance, so arrived, is the amount of assets available for distribution among the Creditors.

### **Deficiency Account:**

In addition to various lists- Lists A to List G-the Debtor has to prepare a Deficiency Account which explains as to how the deficiency shown in the Statement of Affairs has arisen. The insolvent debtor is required to account for the loss to the amount of his capital and of his Creditors.

### **On the left- hand side of Deficiency Account appears:**

- (1) The amount of capital,
- (2) Increment to the Capital from the business i.e., profits, interest on capital, salaries, commission etc.,
- (3) Additional contributions and
- (4) Realisation profits etc.

On its right side appear all the losses and withdrawals by which capital is decreased. The difference between the two sides represents deficiency and this must agree with the deficiency amount as disclosed by the Statement of Affairs.

**Specimen of Deficiency Account is shown below:**

<b>List 'H'</b>			
<b>Deficiency Account</b>			
	Rs.		Rs.
Excess of assets over liabilities on .....	* *	Net Loss arising from carrying on business from ..... to .....	
Net Profit arising from carrying on business from ..... to .....	* *	the date of adjudication	* *
after meeting normal trade expenses		Bad Debts (as per list 'F')	* *
Income or Profit from other sources since .....	* *	Expenses incurred since .....	
Deficiency as per Statement of Affairs	* *	other than usual business expenses, viz., household expenses	* *
		Other Losses :	
		Speculation Loss	* *
		Loss on realisation of :	
		Land and Building	
		Plant and Machinery	
		Furniture and Fixtures	
		Stock-in-trade	
		Other assets	* *
	* *		* *
	* *		* *

**Priority of Payments:**

**The Official Assignee or Receiver realizes the assets and distributes the proceeds in the following order of priority:**

1. Fully secured creditors, in full
2. Partly secured creditors to the extent they are secured
3. Expenses of realisation and remuneration to the receiver
4. Preferential creditors
5. Unsecured creditors, including uncovered balance of partly secured creditors.

**Interest:**

A creditor is not allowed to claim interest after the date of insolvency. However, if all the claims have been satisfied in full, then till the date of payment, interest @ 6% is allowed.

## Loan from Wife:

If the wife has given the loan to her husband out of her personal property or dowry or self-earned income, then the amount of loan is included in Creditors. But if the wife's loan is out of the money given to her by her husband, then the loan is taken as the capital of Insolvent, that is, such amount is not included in the creditors list.

## Illustration 1:

What are Preferential Creditors in the following liabilities of an insolvent, Gopal, according to the Presidency Towns Insolvency Act and Provincial Insolvency Act?

	Rs.
1. Salaries	1,000
2. Sales Tax	300
3. One month wages of 10 labourers	1,200
4. Income Tax	700
5. Rent for 3 months	900
6. Municipal taxes	250
7. Salary for four clerks for two months	1,500
8. Wages of 3 servants	900

### SOLUTION

Item	Total	Presidency Towns Insolvency Act		Provincial Insolvency Act	
		Preferential Creditors	Non-preferential Creditors	Preferential Creditors	Non-preferential Creditors
	Rs	Rs	Rs	Rs.	Rs.
1. Salaries	1,000	1,000		1,000	
2. Sales Tax	300	300		300	
3. Wages of 10 labourers	1,200	1,000	200	200	1,000
4. Income Tax	700	700		700	
5. Rent	900	300	600	Nil	900
6. Municipal tax	250	250		250	
7. Salary for four clerks	1,500	1,200	300	80	1,420
8. Wages of 3 servants	900	300	600	60	840
	6,750	5,050	1,700	2,590	4,160



**Illustration 2:**

On 1st April 2003, Mohan commenced business with a capital of Rs. 63,500. His profits for the years 2003-04 and 2004-05 amounted to Rs. 55,540. He suffered a loss of Rs. 25,000 in the year 2005-06. His total drawings up to 31st March 2006 were Rs. 90,000

From the following figures, prepare a Statement of Affairs and Deficiency Account of Mohan as at 31st March 2006:

	Rs.
Cash	2,300
Stock-in-trade	10,000
Debtors – good	70,000
Debtors – doubtful	18,000
Debtors – bad	15,000
Fixtures and Fittings	5,640
Investments in shares	5,000
Unsecured Creditors (including Rs. 10,000 of his wife)	1,30,000

Secured Creditors	25,000
Value of securities held by secured creditors	35,000
Preferential claims – taxes etc.	1,900
Assume that:	
the stock-in-trade will realise	6,660
fixtures and fittings	2,820
investment in shares	the book-value
the bad and doubtful debts	6,000

(B.Com.MS, Kerala)

## SOLUTION

Statement of Affairs of Mohan as on 31st March 2006.

Gross Liabilities Rs.	Liabilities (As stated and estimated by the Debtor)	Rs.	Expected To Rank Rs.	Assets (As stated and estimated by the Debtor)	Book Value Rs.	Estimated to Realise Rs.
1,30,000	Unsecured creditors as per List A		1,30,000	Property as per List E:		
25,000	Secured creditors as per List B	25,000		Cash	2,300	2,300
	Less: Estimated value of securities	35,000		Investment in shares	5,000	5,000
	Surplus as per contra	10,000		Stock	10,000	6,660
	Partly secured creditors as per List C			Fixtures and Fittings	5,640	2,820
1,900	Preferential Creditors as per List D	1,900		Book Debts as per List F		
	Deducted as per contra	1,900		Good	70,000	70,000
				Doubtful	18,000	6,000
				Bad	15,000	—
				Surplus from Securities in the hands of creditors, fully secured		10,000
				Bills Receivable as per List G		—
						1,02,780
				Deduct preferential creditors as per contra		1,900
						1,00,880
				Deficiency as per List H.		29,120
		1,30,000				1,30,000

### Deficiency Account (List H)

	Rs		Rs
Excess of Assets over Liabilities or Capital	63,500	Net Loss 2005-06	25,000
Profits for 2003-04 and 2004-05	55,540	Bad Debts (List F)	27,000
Deficiency as per Statement of Affairs	29,120	Drawings	90,000
		Loss on realisation:	
		Fix. & Fittings	2,820
		Stock	3,340
	1,48,160		6,160
			1,48,160

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