Insolvency Accounts

Meaning of Insolvent

A person who is unable to pay his debts or discharge his liabilities in full is called insolvent. In common words, when a person has no amount or assets to pay his debts, he is called insolvent. In other words, when a debtor becomes incompetent to discharge his debts or liabilities, he is known as insolvent. But in law, however a person is declared as insolvent provided his liabilities exceed his assets and when he is so declared by a competent court.

Definition of Insolvency

The Indian Insolvency Act does not define insolvency clearly but this word is defined by Indian Sales of Goods Act, 1930. According to Section 2(8) of this act,

"A person is said to be 'insolvent' who has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due, whether he has committed an act of insolvency or not."

Justice Blackstone has defined insolvency as follows :

"Bankruptcy is a proceeding by which, when a debtor cannot pay his debts or discharge his liabilities or the persons, to whom he owes money or has incurred liabilities, cannot obtain satisfaction of their claims, the state, in certain circumstances, takes possession of his property by an officer appointed for the purpose, and such property is realized and distributed in equal proportions among the persons to whom the debtor owes money or has incurred pecuniary liabilities."

Conditions for Declaring Insolvent Under Insolvency Act

For declaration of a person as an insolvent, it is essential to fulfill the following two conditions :

(i) His liabilities should be more than his assets ; and

(ii) He must be adjudged insolvent by a competent court.

There is no difference between the two words insolvency and bankruptcy, the fact is that first word is used in India and the second in United Kingdom.

Insolvency Act in India

In India, two acts of insolvency are implemented :

(i) The Presidency Towns Insolvency Act, 1909 ; and

(ii) The Provincial Insolvency Act, 1920.

The latest amendment to both the Insolvency Acts was made in 1978 by Insolvency Laws (Amendment) Act 1978, which is implemented from 1st September, 1978.

The Presidency Town Insolvency Act is applied in the Presidency towns of Mumbai, Chennai and Kolkata and the Provincial Insolvency Act is applied in rest of India. Under these acts, rules regarding procedure for declaring a person insolvent and distribution of his assets among creditors are given.

Area of the Acts

The above both laws are applied on an individual, Joint Hindu Family, the firm and other community of persons but it is not applied on companies and on minors. In case of insolvency of a company process of liquidation made under Indian Companies Act, 1956.

Procedure of Declaring Insolvent

The procedure of insolvency is as follows :

1. To File an Application
2. Order of Adjudication by the Court
3. Realization and Distribution of Debtor's Assets Under Supervision of Court
4. Discharge of Insolvent.

1. To File an Application. Application (Petition) for adjudication as insolvent may be presented either by the debtor or by the creditor in a court. The court takes necessary action on the basis of this petition.

A. To Present Petition by Debtor. A debtor can present an insolvency petition in the court under the following conditions–

(i) when his debts amounted to ₹ five hundred or more ;

(ii) when he is under arrest or imprisonment in execution, of the decree of any court for non-payment in cash;

(iii) when an order of attachment in execution of such decree has been made ; and

(iv) when he is uenable to pay the amount of his debts.

B. To Present the Petition by the Creditors. A creditor can present an insolvency petition in the court under the following conditions–

(i) his debts is ₹ 500 or more ;

(ii) the debt is payable either immediately or after a certain period in future ; and

(iii) the debtor had done any action of insolvency within three months prior to presentation of petition.

The action of insolvency is explained under Section 9 of Presidency Towns Insolvency Act, 1909 and under Section 6 of Provincial Insolvency Act, 1920.

2. Order of Adjudication by the court. After admitting the petition of insolvency, the court makes necessary action. If court is satisfied that the petition is reasonable, it shall pass an "Order of Adjudication" and the debtor is declared insolvent.

3. Realisation and Distribution of Debtor's Assets Under Supervision of Court. After making the order of adjudication, the total assets of the insolvent vests in the court which is realized and distributed among the creditors by the official receiver or assignee.

4. Discharge of Insolvent. A debtor can apply to the court for an order of discharge within the period specified by the court after the order of adjudication. An order of discharge by the court is passed to release the insolvent from all debts and his personal disqualifications are removed. After that he can start a new life with a new business.

Accounts and Statements Under Insolvency

The following accounts and statements are prepared under insolvency :

(i) Statement of Affairs ; and

(ii) Deficiency Account

(*i*) Statement of Affairs. A Statement of Affairs is to be prepared if a person or a firm is adjudicated as insolvent in order to show the true financial position, almost like a Balance Sheet. Here, the assets must be shown at realisable values and liabilities expected to payable.

(*ii*) Deficiency Account. Deficiency Account expresses the amount contributed by the proprietor and the amount lost by him as well. In this account, the amount which is contributed by the proprietor is shown on the left hand side and losses including drawing are shown on the right hand side.

Preparation of Statement of Affairs

Statement of Affairs is prepared by debtors according to the prescribed form issued by Supreme Court/High Court. It is submitted by each debtor to Official Assignee in Mumbai, Chennai and Kolkata and in rest of India, it is submitted to Government Receiver.

There are two sides of Statement of Affairs :

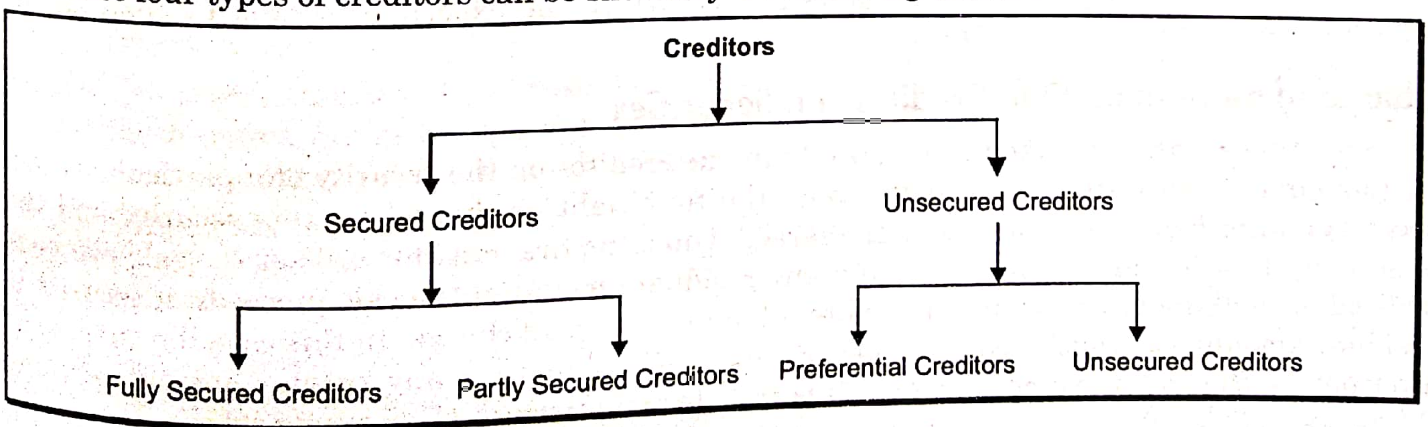
(A) Liabilities Side ; and

(B) Assets Side

A. Liabilities Side. Liabilities side is related to creditors. It is divided into four parts and for this, separate four lists are prepared which are as follows :

1. list 'A' –For Unsecured Creditors ;
2. lit 'B' –For Fully Secured Creditors ;
3. list 'C' –For Partly Secured Creditors ; and
4. list 'D' –For Preferential Creditors.

These four types of creditors can be shown by the following charts :



Detailed Description of Each list

1. list 'A' – The full and detailed description of unsecured creditors are given in this list, for example : amount due and paid to each unsecured creditors ; total amount due and total amount