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Rajgurunagar – 410505

Second Year B.Com

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Subject – Corporate Accounting

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Topic 3 – Accounting for Liquidation of Companies

- **MEANING OF LIQUIDATION -**

A Company is an artificial person and it is created by law therefore the law alone can close it. Liquidation of company refers to a process in which a company's existence is brought to an end. On liquidation the affairs of a company are wound up and its name is struck off from the Register of the Registrar of Companies and this fact is published in the Official Gazette.

As per section 270 of the Companies Act 2013, the procedure for winding up of a company can be initiated either:

(a) By the tribunal or,

(b) Voluntary.

I. **Winding up of a Company by a Tribunal –**

As per section 271 of the Companies Act 2013, a company can be wound up by a tribunal in the following circumstances:

1. If the company has by special resolution resolved that the company be wound up by the tribunal.
2. If the company has acted against the interest of the integrity or morality of India, security of the state, or has spoiled any kind of friendly relations with foreign or neighbouring countries.
3. If the company has not filed its financial statements or annual returns for preceding five consecutive financial years.
4. If the tribunal by any means finds that it is just and equitable that the company should be wound up.
5. If the company in any way is indulged in fraudulent activities or any other unlawful business, or any person or management connected with the formation of company is found guilty of fraud, or any kind of misconduct.

II. Filing of Winding Up Petition –

Section 272 provides that a winding up petition is to be filed in the prescribed form in 3 sets. The petition for compulsory winding up can be presented by the following persons:

- The company
- The creditors;
- Any contributory or contributories

- By the central or state govt.
- By the registrar of any person authorized by central govt., for that purpose

The tribunal after hearing the petition has the power to dismiss it or to make an interim order as it think appropriate or it can appoint the provisional liquidator of the company till the passing of winding up order.

III. Voluntary Winding Up of a Company –

The company can be wound up voluntarily by the mutual agreement of members of the company, if:

i. The company passes a Special Resolution stating about the winding up of the company.
ii. The company in its general meeting passes a resolution for winding up as a result of expiry of the period of its duration as fixed by its Articles of Association or at the occurrence of any such event where the articles provide for dissolution of company.

- **Contributory -**

According to the Companies Act a contributory is "every person liable to contribute to the assets of a company in event of its being wound up, and includes a holder of fully paid-up shares and also any person alleged to be contributory". In the event of liquidation of a company, the liquidator prepares two lists of contributories:

(i) List 'A':

This list consists of those persons who are members of the company on the date of the winding up. In simple, List 'A' contributories is the list of the present members of the company. They are liable to contribute the amount remaining unpaid on the shares held by them if the amount is needed to make payment to legal claimants.

The holders of fully paid-up shares are also treated as contributories even though they are not required to contribute anything to the company. This is necessary because in such a case, the court will know, not only those who will contribute but also who will share the surplus, if any.

(ii) List 'B':

This list consists of those persons who were the members of the company during the 12 months preceding the date of winding up. In case the assets of the company are not sufficient to pay the liabilities of the company in the event of company's winding up liquidator can ask List 'B' contributories to contribute towards the assets of the company, subject to certain conditions. However their liability is restricted to the amount not called up when the shares were transferred.

- **Liquidator –**

The person appointed for conducting the liquidation proceedings of the company is called 'Liquidator'. (In case of Voluntary winding up an Insolvency Professional). The company must submit a statement of affairs to the liquidator. The general duties of the liquidator are to take into his custody all the property of the company and actionable claims and make the payments as per the order laid down in the Companies Act.

- **LIQUIDATORS FINAL STATEMENT OF ACCOUNT –**

The main duty of the liquidator is to collect the assets of the company and realize them and distribute the amounts realized among the right claimants. He is required to prepare a statement and submit the same to registrar of companies, after the company is completely wound-up. In case of voluntary winding up such statement is called "Liquidators Statement Account". In case of winding up by Tribunal it is called as "Official Liquidators Final Account". It is a statement of receipts and payments which is prepared in the form of an account.

The form of the Liquidator's Final Statement of Account is given below. Liquidator's Statement of Account

Receipts	Amount	Payments	Amount
To Assets Realised - Cash at bank - Cash in Hand - Marketable securities - Bills Receivables - Trade Debtors - Stock in trade - Freehold property - Plant and Machinery - Furniture and fittings	**xx**	By Legal Charges By Liquidation Expenses By Liquidators Remuneration By Preferential Creditors By Debenture holders (having a floating charge on the assets of the Company) By Unsecured Creditors By Preference Shareholders BY Equity Shareholders	**xx** **xx** **xx** **xx** **xx** **xx** **xx** **xx**
To Surplus from securities held by secured creditors	**xx**		
To proceeds from calls made on contributories	**xx**		
Total	**xxx**	**Total**	**Xxx**

- **Explanation for Important Terms –**

1. **Order of payment:**

After receiving the amounts realized on assets, surplus from fully secured creditors and by making calls for the unpaid amount on the shares held by shareholders, the liabilities are paid out by the liquidator in the following order:

(a) Legal expenses

(b) Remuneration of the liquidator

(c) Cost of winding up / Liquidation Expenses

(d) Payment to preferential creditors

(e) Payment to debenture holders having floating charge on the assets of the company.

(f) Payment to unsecured creditors

(g) Payment to preference shareholders

(h) Payment to equity shareholders.

2. **Liquidator's Remuneration:**

The liquidator normally gets the remuneration in the form of commission which is usually based as a percentage on the value of assets realized and amount paid to unsecured creditors. In calculating the liquidator's remuneration, the following points may be noted:

(a) On assets realized:

The term 'assets realised' does not include cash and bank balances as the liquidator does not realize cash and bank balances. However, in some cases cash and bank balances are given in the list of assets realized by the liquidator, then the remuneration has to be calculated even on cash and bank balances.

Some assets are given as security to secured creditors. If the assets given as security are sold by the liquidator, he will get remuneration on the securities sold by him. If the securities are sold by the creditors and the surplus after deducting the amount due to them is given to the liquidator, then remuneration is given to the liquidator on such surplus from securities.

(b) On amount paid to unsecured creditors:

Unless otherwise stated, for the purpose of calculating liquidator's remuneration, the term unsecured creditors includes preferential creditors as basically they are also unsecured creditors.

The Commission is calculated as follows:

(i) If the amount available is sufficient to pay unsecured creditors = Preferential

Creditors + Unsecured Creditors × Rate/100.

(ii) If the amount available is insufficient to pay Unsecured Creditors in full = Amount

available × Rate/100 + Rate

Note: In some cases, the remuneration is paid on amount paid to shareholders. Commission = Amount available before paying shareholders × Rate/100 + Rate.

3. **Preferential payments:**

Preferential creditors are those creditors who are paid in priority to creditors having a floating charge and other (non-preferential) unsecured creditors. As per Sec. 326 of the Companies Act, 2013, preferential creditors include the following:

1. All revenues, taxes, cesses and rates due to the Central, State Government or to a local authority which have become due and payable within twelve months before the date of winding up order.

2. All wages or salaries of any employee not exceeding ` 20,000 per claimant, in respect of services rendered to the company and due for a period not exceeding four months within the said twelve months before the date of winding up order.

3. All amounts due in respect of contribution payable during the twelve months under the Employees' State Insurance Act, 1948 or any other law.

4. Compensation due under Workmen's Compensation Act, 1923 in respect of death or disablement of any employee of the company.

5. Any amount due to any employee from provident fund, pension fund, gratuity fund for the welfare of the employees maintained by the company.

6. Accrued holiday remuneration becoming payable to the employee or in case of his death, to any other person in his right, on termination of his employment before, or by the effect of the winding up.

7. The expenses of any investigation held in pursuance of Sec. 213 or 216 in so far as they are payable by the company.

Overriding Preferential Payments (Section 326)

Overriding preferential payments are to be paid in priority to all other debts as per the said Act.

They include:

(a) Dues to workmen, and

(b) Debts due to secured creditors to the extent such debts rank to the security of every creditor shall be deemed to be subject to pari passu charge in favor of the workmen to the extent of workmen's portion therein.

4. **Interest on Debentures:**

If the company is solvent, interest due on debentures shall be paid upto the date of actual payment. If the company is not solvent, interest should be paid upto the date of liquidation.

5. **Payment of arrears of preference dividend:**

The question of preference dividend arises only if the preference shares are cumulative. If the Articles of Association provides for the payment of arrears of dividend on the event of winding up and the said arrears should pertain to the period before liquidation, the arrears shall be paid after paying off the liabilities but before returning the preference share capital. Dividends in any case are not payable for any period after the date of winding up.

The question of whether the arrears of dividends to preference shareholders is to be paid first or the repayment of share capital to equity shareholders is to be made first, depends upon the provisions of the Articles of Association.

6. **Calls on Contributories:**

The shareholders in the liquidation of the company are known as contributories. They are liable to pay to the extent of unpaid amount on the shares held by them. In case the liquidator is not in a position to pay the creditors in full, and if there are any partly paid shares, the liquidator will make a call on the contributories to the extent required, not exceeding the amount unpaid on the shares. If there are two or more categories of equity shares on which equal amount is not called up by the company. In such a case, the liquidator will have to adjust the rights of the shareholders in an equitable manner.

- **Preparation of Statement of Affairs**

Where the court has made a winding up order or appointed the official liquidator as a provisional liquidator, the officers and directors of the company must submit, within 21 days of the court's order (or within such extended time, not exceeding 3 months, as the official liquidator or the court may permit), a Statement of Affairs in the form prescribed.

Following lists are attached to the Statement of Affairs:

❖ **List A** gives a complete list of assets not specifically pledged in favour of secured creditors. Creditors having a floating charge on the assets are considered as having assets not specifically pledged with them; so such assets are included in the list.

- **List B** gives the list of assets which are specifically pledged in favour of fully secured and partly secured creditors.
- **List C** gives the list of preferential creditors.
- **List D** gives the list of debenture holders and other creditors having a floating charge on the assets.
- **List E** gives the names, addresses and occupations of unsecured creditors and the amount due.
- **List F** gives the names and number and value of shares held by various preference shareholders.
- **List G** gives the names and holdings of equity shareholders.
- **List H** shows how Deficiency or Surplus in the Statement of Affairs has been arrived at, i.e., it explains the reasons responsible for the surplus or deficiency. According to the law, the period covered by Deficiency or Surplus must commence on a date not less than 3 years before the winding up order, or if the company has not been incorporated for the whole of that period, the date of incorporation of the company, unless the official Liquidator otherwise agrees.

- **Deficiency/Surplus Account (List H) –**

Statement of Affairs shows the Deficiency/Surplus as regards creditors and members. This account explains how the deficiency or surplus has arose. This statement must cover at least a 3 year period preceding the date of winding up order.

This statement starts with capital and liabilities in excess of assets as on a given date. To this are added items contributing to deficiency (or reducing surplus) such as Net trading Losses, Losses other than trading losses written off, etc. From the total, items reducing deficiency (or contributing to surplus) such as excess of assets over capital and liabilities, Net trading profit made during the period, profits and income other than trading profits etc., are deducted. The resultant Net surplus/deficiency must tally with the figure shown in the Statement of Affairs.

Reference –

"The Institute of Chartered Accountants of India"