

LEGAL AND ACCOUNTING IMPLICATIONS OF BANKRUPTCY TO BUSINESSES IN NIGERIA

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Abstract

Given the current wave of gross inability to meet financial obligations by many business owners, this paper examines the legal and accounting implications of insolvency (leading to bankruptcy) to businesses and its developmental contribution to Nigeria's burgeoning economy. We employed a desk review, exploring the different meanings, implications and consequences of bankruptcy and its applications from literature sources. Literature sources include academic and newspaper publications as well as other relevant articles and internet sources. We find that statutory bankruptcy provisions as well as institutional support for bankruptcy proceedings may still be inadequate to respond to these peculiar times as culture plays its own role. Unfortunately, we could hardly get information on bankruptcy proceedings in Nigeria, which testifies to its suboptimality as an effective debt recovery mechanism. In addition, the difficulty in ascertaining which debtor is trying to sabotage the efforts of their creditors is a significant challenge. Creditors on the other hand are mostly averse to initiating a bankruptcy proceeding due to traditional and socio-cultural concerns. This paper reports the consequence of insolvency leading to Bankruptcy and its implication to business development in Nigeria from the legal and accounting eyes.

Keywords: Bankruptcy, Going concern, Insolvency and Liquidation

Introduction

Entrepreneurship has gained grounds in the curricula of tertiary institutions in Nigeria as a core course even in pure sciences (Garba, 2010). This is an attempt by Government to reduce graduate dependence on ready-made jobs, which has become inadequate in recent times based on rising unemployment – national unemployment rate for the third quarter of 2018 was 23.1%, while the underemployment rate was 20.1% (National Bureau of Statistics, 2019). The motivation for entrepreneurship studies was therefore to inspire graduates to build empires of their own and stresses start-ups which are mostly run in owner-manager or partnership arrangements and structures. Despite an increasing number of Nigerian start-ups, it is reported that about 61% fail (Oluwabunmi, 2020; Onoja, 2020). It is instructive to posit that this statistic is pre COVID-19. One can then only imagine the twist that the present pandemic adds to the failings of businesses.

Running and sustaining a business is hard work and these trying times make it harder. This is even more so that Nigeria used to rank behind in the “Ease of doing business” index (World Bank, 2020). Considering severe cost cutting and cost saving strategies by established and “too big to die” entities, one can only wonder how micro-, small- and medium-sized entities (MSMEs) are faring. Due to the effect of this current pandemic, many entities have become insolvent, being unable to meet obligations, while others have gone under. Many Governments have provided some forms of palliatives, yet it appears it is insufficient to stem the tide of gross inability to meet overheads, resulting into many bad debts. To recover these debts, even creditors and other lenders being aware of the situation are giving some forms of leeway to debtors. How long can this be or better still, how sustainable is this?

An ultimate debt recovery and debt-freedom mechanism being considered among especially owners and managers of MSMEs is the bankruptcy proceeding. However, although Nigeria appeared as the last of ten most improved countries in the ease of doing business, “resolving insolvency”, one of the measuring parameters according to latest results did not improve from May 2018 to May 2019 (World Bank, 2020). This is probably one of the factors fuelling the 2020 Bankruptcy Bill.

Ordinarily, a business is a going concern and a separate legal entity, however the inability of business owners – especially sole proprietorships and partnerships – to meet their obligations could end the life of the business and may have far-reaching implications on the owner(s) and partners, if declared bankrupt. From an accounting point of view, businesses operate as a separate entity from its owner(s). This echoes the business entity concept that posits that ‘a business is registered in its own name and can sue and be sued independent of its’ owner(s) under the law’. The Bankruptcy Act Cap B2 LFN 2004 provides that the owner of a business who is unable to meet his/her financial obligations can be declared bankrupt which invariably terminates the life of the business and as well affects the owner due to unlimited liability. Also, a business is considered a going concern implying that the business is meant to be an immortal being operating for life, but bankruptcy can terminate the life of the business and disallow the owner(s) to establish another business during the bankruptcy period prior to discharge (Moore, 2017).

Accounting practice is regulated through self-regulation by professional accounting organisations, by law and governments, hence accounting is held as an offshoot of law; this creates tensions of

some sorts (Laughlin, 2011). At the end what holds is the supremacy of law and governments. The legal view of sustainable businesses tightly correlate to the ability of the owner(s) to meet obligations to creditors and other lenders such that once they are unable or even show signs of inability to meet financial obligations, it is deemed that creditors can initiate proceedings which might eventually terminate the life of the business and make the owner(s). to be declared bankrupt. However, such provisions are not available in the accounting domain. This paper therefore presents a discourse of bankruptcy from both an accounting perspective and the legal viewpoint.

Objective and questions

Our primary motivation is to provide a commentary on the views of accounting and law on bankruptcy. We also discuss and clarify some related issues and comment on the effect of some provisions of the bankruptcy legislation on business development. Specific questions that we respond to include:

1. To what extent do the institutional difference in meaning of bankruptcy affect business ownerships in Nigeria?
2. What factors influence the initiation of bankruptcy proceedings in Nigeria?
3. In what ways are bankruptcy and business development in Nigeria correlated?
4. How sufficient are the provisions of Nigerian bankruptcy legislations during the COVID-19 pandemic?

Discourse

Accounting perspective

Accounting (especially reporting) is guided by basic (traditional) concepts, conventions, bases and principles. Two accounting concepts are relevant to this paper's discourse – Going concern concept and Business entity concept.

The going concern concept explains that a business (entity) is deemed to be a *life-affair*. Despite this underlying assumption, businesses shut down and sometimes, abruptly due to death or incapacity of an owner-manager, poor working capital management and the like. Business failures resulting from acute insolvency counters the going concern concept. The cause of the death of these businesses range from the unavailability of a suitable successor to inability of the successors

to carry on with the vision of the owner to mismanagement of the business funds that leads to bankruptcy etc.

The business entity concept explains that the business (including cost, investment, revenue and profit centres) is quite different from the owner(s). It elucidates the difference between the business and the owner giving the business an entirely pseudo-dynamic personality. This concept is what gives credence to the incorporation status of a company as an entity that can “sue and be sued in its corporate name” (Federal Government of Nigeria, 2004). Except in exceptional cases where the veil of ownership is lifted, a business operates as a separate legal entity from its owners.

The business entity concept however bends to the extent of liability – limited and unlimited. Sole business owners and some classes of partners suffers unlimited liability. Bankruptcy proceedings may be initiated if their business fails and they are also unable to meet the outstanding obligations using their personal property. However, shareholders of companies limited by shares do not guarantee their personal estate if the company fails – all that can be lost is the capital in the form of shares. Managers of companies may however be subject to bankruptcy proceedings if they are personally liable for the debts of their company (Eghobamien, 2016).

There is a standing paradox between accounting and Law. One of such bother on an accounting concept of “substance over form”. For example, the law governing hire purchase suggests a clarity between ownership and possession. However, in accounting, once a reporting entity takes possession and commences the use of a non-current asset, it is expected that it is treated as a Property, Plant and Equipment – PPE (IAS 16). We recognise a similar disparity with respect to bankruptcy. Accounting concepts stipulates that a business as a going concern is also a separate legal entity, however, if a business owner under the sole proprietorship or partnership business arrangement is unable to meet financial obligations, it affects their business(es), their properties and personalities under the law, based on concept of ownership liability in business.

Insolvency

Insolvency is sometimes in advertently used as a synonym for bankruptcy (Oyedepo, 2008). The true sense of the word is an inability to meet obligations when they are due. Depending on the severity of insolvency, which is sometimes referred to as illiquidity. It must also be noted that there is a significant difference between liquidity and profitability.

The inability to accurately determine a state of acute insolvency presents a leeway for debtors. For example, if more than one debt is acquired on the same day on varied and different repayment terms, it becomes difficult for creditors and other lenders to lay claim or move for bankruptcy proceeding against the debtor. This allows for “robbing Peter to pay Paul”.

Bankruptcy

The term bankruptcy is usually linked to *bancus ruptus* (Latin), *banco rotto* (Italian) and *banche route* (French) (Arop, 2019; New Generation Research, 2020; Osunlaja, 2014). These early descriptions point to the physical breaking of a trader (especially a banker’s) table for inability to continue in business. It appears that the Bible (the books of Leviticus and Deuteronomy) provides reliable evidence of the history of bankruptcy as it is referred to as the basis for the practice of Bankruptcy (see Kalu & Agaezichi, 2017). It is also traced to England and Greece (New Generation Research, 2020).

Bankruptcy does not happen in a day; it is a gradual process stemming from inability to meet short term obligations to creditors and other lenders which cause has been adjudged to be precipitated by poor planning, inadequate provision for contingencies and outright mismanagement leading to acute illiquidity invariably leading to the untimely death of the business (Fujiwara, 2008). Though in human life, untimely death is not uncommon but for a business considering the going concern concept, it is abnormal. Insolvency which can also be called illiquidity is a serious concern to business development; this is seen by the importance attached to Liquidity Management (Working Capital Management) as a course and its relevance in management functions. Since finance is referred to as the life-blood of a business; if a business is short of it, the business is dead. It is instructive to express here that liquidity is different from profitability; a business can churn out profit on its Financial Statement (FS) but be low on liquidity. A major concern in this paper is that though the accounting concept of going concern is functional, insolvency can render it null and void.

In many climes bankruptcy and liquidation have varied uses, but in Nigeria it is different. Individuals who are unable to meet their obligations may be forced into bankruptcy, while companies that experience chronic insolvency may be forced into liquidation – also referred to as winding up (Opara, Okere, & Opara, 2014; Oyedepo, 2008). In essence, individuals can be declared bankrupt, while companies can be wound up or be liquidated.

Bankruptcy Act, Cap B2 LFN 2004 declares bankrupt any person who cannot pay his(*her*) debts of a specified amount and to disqualify him(*her*) from holding certain elective and other public offices or from practicing any regulated profession (except as an employee). It further states that the person must not owe less than the sum of “two thousand Naira only (₦2,000.00).”

Due to the fact that the bankruptcy legislation in Nigeria did not explicitly define bankruptcy as a term (Ajayi & Basiru, 2003), many authors have resorted to dictionary meanings from Black's Law Dictionary, 5th, 7th, 8th & 9th eds. and Osborn's Concise Law Dictionary 6th & 9th eds. (Arop, 2019; Kalu, 2010; Oke, 1998; Opara et al., 2014; Oyedepo, 2008).

The underlying definition refers to a person's legal status and process involving an inability to meet obligations and a legal process to enforce an injunction to as much as possible equitably share the debtor's possession among creditors. Bankruptcy is a legal status of a person that cannot repay the debts s/he owes to creditors. In most jurisdictions, bankruptcy is imposed by a court of competent jurisdiction and the proceeding may be initiated by a debtor or a creditor. Bankruptcy is not the only legal status that an insolvent person may have, and the term bankruptcy is therefore not a synonym for insolvency or illiquidity; insolvency has no legal standing. In Nigeria, bankruptcy is limited to individuals.

Debt restructuring, recovery, and forgiveness

Debt restructuring, recovery, and forgiveness are strategies to sustain business relationships and existence. These are employed to mitigate cases of gross insolvency and bankruptcy. There are some major institutions with specialist knowledge and skills in these issues ranging from businesses to membership-based associations. Prominent among associations are the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN), Institute of Debt Recovery Practitioners of Nigeria (IDRPN) and International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL International).

Asset Management Corporation of Nigeria (AMCON) was established to assist in cleaning toxic debts in Nigeria.

Bankruptcy legislations in Nigeria

The need for an effective debt recovery mechanism birthed the need for bankruptcy legislation. According to (Kalu, 2010) “bankruptcy laws were enacted to provide and govern an orderly and equitable liquidation of the estates of insolvent debtors”. As with many of Nigeria’s legislation, bankruptcy legislation have ample semblance to English Law (Arop, 2019).

The first law of bankruptcy in Nigeria is the Bankruptcy Act, 1979. Since then the legislation has undergone some amendments and there is a bill to repeal and re-enact bankruptcy legislation before the National Assembly, which has passed first reading in February 2020 (Placbillstrack, 2020). **Table 1** show a progression of bankruptcy legislations in Nigeria till date. In its current state, the Bankruptcy law allows for fraud, giving a cheat or a fraudster a platform to take advantage of its provisions to suit selfish, parochial interest as well as mundane personal and selfish permutations(Kalu, 2010)

Table 1: Bankruptcy legislations in Nigeria

Year	Name	Details
2020	Bankruptcy and Insolvency Act (Repeal & Re-enactment) Bill	Passed first reading (February 2020)
2004	Bankruptcy Act	Cap B2, Laws of the Federation of Nigeria
1992	Bankruptcy (Amended) Decree	No. 109, Laws of the Federation of Nigeria
1990	Bankruptcy Act	Chapter 30, Laws of the Federation of Nigeria
1979	Bankruptcy Act	No. 16

There is consensus on the need for reforms to the current bankruptcy legislation in Nigeria and such calls have continued to resonate at different for a

Bankruptcy Proceeding in Nigeria

According to Oke (1998) the penultimate step to the commencement of bankruptcy proceedings is that the debtors must have committed an act of bankruptcy. Other steps include, presentation of a petition by either the creditors or the debtors themselves, making a receiving order by the court, appointment of Official Receiver, composition with creditors or a scheme of arrangement, public examination of the debtor, adjudication, administration of the debtor's estate by approved trustee to be monitored by a committee of inspectors and finally the discharge of the bankrupt before or after five years of being declared bankrupt.

“Federal High Court is vested with exclusive jurisdiction in respect of bankruptcy proceedings” (Ajayi & Basiru, 2003, p. 13). In addition, according to Rule 17, it has to be filed in the place where the debtor carried on business rather than where he resides (Ajayi & Basiru, 2003).

Major constraints to bankruptcy proceeding in Nigeria include political instability, egocentrism of the capitalists’ oriented class ruling the nation willy-nilly, circumvention of the Law by the ruling class, inadequate enforcement of the provisions of the Bankruptcy Act, administrative bottle-neck and judicial circum-navigation inherent in the enforcement of the bankruptcy law in Nigeria(Oke, 1998). It is also important to note that there is a gap between theory and practice of bankruptcy proceedings in Nigeria, hence though a creditor may be advised to initiate bankruptcy proceedings as a last resort, in practice it is a different ball game. For example, it is required that an act of bankruptcy is committed only when the creditor obtains final judgment or Order places severe limitations on the scope of application of the Bankruptcy Act(Eghobamien, 2016).

Bankruptcy and COVID-19

In recent times, the world has experienced a shift in the way everything used to be. As the curve of coronavirus flattens or spreads evenly, a lot of businesses are affected by the new normal already. This has resulted to debtors’ inability to settle their creditors and make an instigation of bankruptcy order a possibility. There should be an understanding of whether the situation is insolvency or bankruptcy.

However, the *force majeure* clause in law affects bankruptcy as far as the debtor was faithful to their contractual agreement before the pandemic began. As the world returns to shape, it is believed that the individuals and businesses affected by COVID-19 will uphold their going concern and the events will not lead to eventual bankruptcy.

Bankruptcy Practice and Cases in Nigeria

Inadequate data management practices contribute to our inability to identify the first Bankruptcy proceeding in Nigeria as Ajayi and Basiru (2003) lamented the dearth of cases on bankruptcy in the various Nigerian law reports. It is even said that practice of Bankruptcy in Nigeria is “comatose and non-existent” (Osunlaja, 2014).

The bankruptcy petition against Chief Ibeto by now defunct Afribank of Nigeria Plc. for personally guaranteeing his company’s debt was believed to be the first well-fought bankruptcy proceeding

in Nigeria since Omanayi Majekodunmi's case (Iriekpen, 2010). However, no update on the case is accessible online till date. Majekodunmi's case also has no online mention. We could not find any online public record of bankruptcy proceedings for Nigeria. This may be due partly to poor data management practices and socio-cultural implications of a successful bankruptcy proceeding.

Data management (collection, storage, processing etc.) is still inchoate in the Nigerian judicial system, hence, no adequate data on bankruptcy proceedings in Nigeria. An alternative is to go to all Courts of relevant jurisdictions for bankruptcy proceedings and request available data. Given that this study is self-sponsored, we note that such an exercise will require enormous resources and may eventually make the authors bankrupt.

Bankruptcy proceedings is not common in Nigeria due to the "cumbersome nature of the Law" (Eghobamien, 2016), the alien nature of the practice, cultural and social stigma, low expertise and competence among legal practitioners (Ajayi & Basiru, 2003).

As with other provisions in the legislation, one prominent concern is the value of two thousand Naira (₦2,000.00) only; it is deserving of review. It is hoped that the bill before the National Assembly will factor in recommendations from practitioners and other stakeholders such as the INSOL International.

Bankruptcy and Business Development in Nigeria

A manager that mismanages the resources of a business will most likely bankrupt the business, and the trickle-down effect is the death of owner's dreams and aspirations, hope of beneficiaries and a portion of the owner's contribution to national development. Bankruptcy brings to an end a business idea, dream, proposal. In Nigeria, bankruptcy practice relates to individuals and partnerships. Many reasons have been advanced for inability to settle liability as and when due. However, whatever the cause, this otherwise known debt recovery mechanism brings a going concern to an abrupt end. The most appalling is the fact that the person declared bankrupt can never and will never get a chance to rise again (in that trade). Using the exact words of the Law: "...and to disqualify him(*her*) from holding certain elective and other public offices or *from practicing any regulated profession* (except as an employee)". The fellow declared Bankrupt loses credibility from creditors, colleagues, even friends and has to deal with his/her psychology to overcome inherent depression. "The natural feelings of embarrassment and shame in the wake of

declaring bankruptcy can often send individuals looking for quick emotional fixes” (Businessday, 2014). The effects of bankruptcy to business development in Nigeria can be highlighted as follows:

1. Improved business awareness: business owners and managers(knowing fully the consequence of being declared bankrupt) will manage their businesses better;
2. Promotion of fraudulent activities: it could lead to beating the system to gain undue advantage over creditors;
3. It breaks the business life cycle ending hitherto lucrative business ideas;
4. Renders some hitherto employees jobless (and hence their dependents); and
5. Reduces the number of existing businesses that could add value to the development of the economy. Blue-chip organisations add value to economic growth however, small businesses grow an economy.

Business development in Nigeria is essential to economic growth and development. If Nigeria claims to operate a free enterprise, then the development of businesses should be advanced. However, business (and we state categorically) cannot survive in a state where credit is not recoverable. This is why the Global Standing Instruction (GSI) initiated by the Central Bank of Nigeria (CBN) (Central Bank of Nigeria, 2020) is laudable. The GSI allow the tracking of bank accounts of especially chronic debtors and a collection for refund to the creditor.

Misuse of political advantage continue to fuel a deference to good debt (re)payment practice. Oke (1998) lamented that “some political associates in this country have been transformed into emergency contractors and they have become notoriously influential in banks and other financial institutions. To get a loophole for setting the machinery of bankruptcy proceedings in motion against such persons is a difficult task.” A successful bankruptcy proceeding imposes stiff conditions such as a social stigma denying the bankrupt of credit, disqualifying them from holding certain elective and other public offices or from practicing any regulated profession. It is a connotation which most people strive not to be afflicted with. This otherwise effective debt recovery instrument as well as a tool against recalcitrant debtors, is rarely utilised in Nigeria.

Conclusion and Recommendations

Business owners should see to the sustainable running of their businesses to ensure the concept of going concern and bankruptcy will not be a concern.

No one wishes for failures, but a pandemic such as this is refocusing entrepreneurship trainings. Crisis management should begin to be emphasised to early entrepreneurs. In Nigeria, culture and our perceived religiosity tells us to forbid any bad thing. So, preparing for rainy days such as this is not in the dictionary of many. The concern is that if more established entities can fall due to the harsh effect of the pandemic, how would MSMEs survive – especially given the fact that not many can easily evolve new models to remain in business.

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Further reading

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