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Effective for insolvency appointments
made on or after 1 October 2005

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Insolvency Guidance Note (2)

- A liquidator's investigation into the affairs of an insolvent company



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

STATEMENT 1.601

**INSOLVENCY GUIDANCE NOTE (2) – A LIQUIDATOR'S INVESTIGATION INTO
THE AFFAIRS OF AN INSOLVENT COMPANY**

(Effective for insolvency appointments
made on or after 1 October 2005)

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Introduction

1. This Insolvency Guidance Note ("IGN") should be read in conjunction with IGN (1) – *Scope*.
2. This IGN has been prepared for the sole use of members of the Institute in connection with liquidations of companies under the Companies Ordinance (Cap. 32). Members are reminded that IGNs are for the purpose of guidance only and may not be relied upon as definitive statements. No liability attaches to the Council of the Institute or anyone involved in the preparation or publication of the IGNs.
3. This IGN concentrates on the duty of a liquidator of an insolvent company to investigate the company's affairs. The liquidator should carry out a minimum standard procedure in carrying out this duty, whether there are assets or not, and creditors should be confident that the investigating duty has been properly discharged.
4. The purpose of an investigation is to determine the assets and liabilities of the company and to review the conduct, decisions and actions of the directors. If, during the course of the investigation any apparent preferences, dispositions of property after the commencement of the winding-up, or rights of action come to light, the liquidator should determine, if necessary with the benefit of legal advice, whether or not any particular transactions can be set aside.
5. The extent and nature of the investigation work will vary from company to company but should include the following:

Procedure

Question management

6. At the outset of the winding-up, all relevant directors, including directors who held office during the last three years, the company secretary and other senior officials should be questioned as to the company's affairs, including the reasons for failure. The onus is on the liquidator to consider carefully which directors (officials, former directors or shadow directors) are relevant having regard to their accessibility and the information that he believes they may have. Where appropriate, the liquidator may also wish to invite creditors to bring to his notice any particular matters which they consider require further investigation.

Records

7. Once appointed, the liquidator must try to ascertain the location of the books, records and other accounting information belonging to the company and take steps to safeguard them.
8. The records of the company covering a minimum of the previous two years (subject to availability), or such longer period as the liquidator may consider appropriate in the circumstances, should be examined to ensure material transactions in the final period of trading were made in the normal course of business. The nature of the investigation undertaken will depend on the records available and the particular circumstances of the administration. A review of the company's books and records may highlight a preferential payment to a particular party or the acquisition or maintenance of a particular asset not previously disclosed in the financial statements, or dispositions of property that are automatically void by reason of the commencement of winding up. This examination may include a review of the general ledger, for unusual transactions, paying particular attention to director and related-party accounts. The accounting ledgers may also be reviewed in conjunction with cash books, bank statements and cheque books, and material amounts vouched to one another. This may help detect unrecorded payments / receipts and assist the liquidator in assessing the accuracy and completeness, hence reliability of the company's accounting function prior to liquidation. Where the liquidator cannot obtain accounting records for the period prior to liquidation from the company, consideration should be given to obtaining records from other sources, wherever it is reasonably practicable to do so. For example, the liquidator should consider requesting copies of bank statements from the company's bankers and details of particular receipts and payments, as appropriate.

Consideration should also be given to requesting information regarding the company's affairs from creditors and other parties who may be able to provide such information.

Validity of charges

9. Details of all security held by banks and other parties should be obtained and the liquidator should check registration and consider the possible invalidity of any charge. Where the liquidation follows a receivership, the validity of the receiver's appointment should also be assessed.

Comparison of assets with last balance sheet

10. For the purposes of discovery of assets, where relevant, the statement of affairs should be compared with the last audited financial statements. The liquidator should satisfy himself that material movements in fixed and current assets can properly be explained. Where no statement of affairs is provided, the most recent audited financial statements and management accounts should form the starting point for identifying assets owned by the company.

Trading losses

11. Consideration should be given to the preparation of a deficiency account and, possibly also, trading, profit and loss accounts, in any case where there is a material difference between the deficiency disclosed in the statement of affairs and the last audited financial statements, after taking into account matters such as writing-down of asset values.

Transactions with associated companies or connected persons

12. The books and records of the company should be examined for a minimum of two years (subject to availability) to ensure that any transactions with associated companies or connected persons were carried out at arm's length, and material transactions should be examined in detail. Particular attention is drawn to transactions involving directors, including any reduction in loan accounts and/or reduction in overdrafts supported by personal guarantees. Repayment terms of director loans should be noted and any material acquisitions of assets by or disposals to directors and related parties, or transactions which might constitute the giving of any preference to that director or related party in the two-year period preceding the liquidation, should be investigated in detail to determine whether the transactions occurred on commercial terms.

Statutory books

13. The statutory books of the company should be examined, together with the minute book, and compared with a search obtained from the Companies Registry. Particular attention should be given to the identity of directors who held office during the last three years.

General

14. The liquidator's investigation into the affairs of the company should aim to identify any rights of action which the company or the liquidator may have against third parties, and attention is drawn in particular to the following provisions:

Companies Ordinance (Cap. 32)

Sections 47A – 48	Financial assistance
Section 121(4)	Failure to keep or preserve any books of accounts
Section 156(1)	Bankrupt acting as a director
Section 157(J)	Criminal penalties for contravention of section 157H (Prohibition of loans, etc., to directors and other persons)

Section 182	Avoidance of dispositions of property of the company after commencement of winding up
Section 190(5)	Failure to submit a statement of affairs
Sections 212 – 214	Uncalled capital
Sections 266/266B	Fraudulent / unfair preferences
Section 271	Offences by officers of companies in liquidation
Sections 272, 274	Failure to keep proper books of account
Section 273	Frauds by officers of companies which have gone into liquidation
Section 275	Fraudulent trading
Section 276	Misfeasance and misapplication etc. of property
Section 277	Prosecution of delinquent officers and members

Conveyancing and Property Ordinance (Cap. 219)

Section 60	Voidability of dispositions to defraud creditors
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Consideration should also be given as to whether any other rights of action are available, for example, in relation to the common law fiduciary duties of directors, breach of constructive trust, etc.

15. Where a committee of inspection has been set up, the liquidator should, where appropriate, obtain the sanction of the committee in respect of any decision to bring or defend any action or other legal proceedings in the name of and on behalf of the company following the outcome of the above investigation work. This sanction is a statutory requirement in a compulsory winding-up. In all cases, the overriding consideration will be the likelihood of any tangible benefit to the creditors. Where there is no committee of inspection, in a compulsory winding-up, sanction should be sought from the court or the Official Receiver, as appropriate.
16. If, in the course of a winding-up, it should come to the notice of the liquidator that any past or present officer (or member) of the company may have been guilty of any offence in relation to the company for which the officer is criminally liable, then, in a compulsory winding-up, the liquidator should report the matter to the Official Receiver. In a voluntary winding-up, the liquidator's duty is to report the matter to Secretary for Justice (section 277, Companies Ordinance).
17. Attention is also drawn to the requirement that the liquidator must report on the conduct of the directors to the Official Receiver in the circumstances described in section 168I(3) of the Companies Ordinance (see also IGN (4) – *Disqualification of directors – statutory reports*).