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Liquidation and Insolvency

Guidance Note (4)

- Disqualification of directors – statutory reports



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

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**LIQUIDATION AND INSOLVENCY GUIDANCE NOTE (4) –
DISQUALIFICATION OF DIRECTORS – STATUTORY REPORTS**

(Effective as from 1 August 2020)

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Introduction

1. This Liquidation and Insolvency Guidance Note (“LIGN”) should be read in conjunction with LIGN (1) – *Scope*.
2. The LIGN has been prepared for the use of insolvency practitioners¹ (“IPs”) in dealing with statutory reports and returns on directors in connection with insolvent liquidations and receiverships under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32)(“CWUMPO”) and Companies (Reports on Conduct of Directors) Regulation (“Cap. 32J”)(“the Regulation”). IPs are reminded that LIGNs are issued for the purpose of guidance only and may not be relied upon as definitive statements. They do not affect any responsibilities that may be imposed by law or regulations.
3. The law regarding the submission of returns and reports and the disqualification of directors is contained in CWUMPO and the Regulation.
4. In addition, the Official Receiver (“OR”) has issued three circulars elaborating on the requirements. These are OR’s Office (“ORO”) Circular No.6/2014 – *Prosecution of Insolvency Offences*, Circular No.5/2017 – *Prosecution of Insolvency Offences – Supplemental to ORO Circular No.6 of 2014* and Circular No.6/2017 – *Disqualification of Directors*. IPs should refer to these memoranda for detailed guidance in completing returns or reports.
5. An IP appointed as a receiver of a company or a liquidator is required to submit either a report or a return (often known as a “Form D1” and “Form D2”, respectively, and referred to collectively below as “D-form”) to the OR, concerning the directors of the company, within six months from the relevant date (as defined in section 3(4) of the Regulation). The circumstances under which such documents are submitted are further outlined below.
6. In addition, IPs should note that there is a continuing obligation to report to the ORO matters concerning the conduct of directors in order to enable the ORO to consider whether or not an application for a disqualification order should be made. The furnishing of a D-form will not fully discharge the IP’s obligation. He/ she must provide further information and reports to the ORO if additional information comes to light of which the IP might not have been aware when he/ she first submitted the D-form (section 168I(3), CWUMPO).
7. IPs should note that the main provisions of CWUMPO on the disqualification of directors, and the Fifteenth Schedule, on matters for determining unfitness of directors, relate not only to directors/ officers but also to “shadow” directors/ officers, as defined in the relevant sections.
8. No liability attaches to the Council of the Institute or anyone involved in the preparation or publication of LIGNs.

Content of Return / Report and Corresponding Time Limits

9. As outlined above, either a return or a report must be submitted within six months from the relevant date. The D-form will either be an adverse conduct report (referred to below as a “report”) giving details of conduct that may render the director unfit to hold office, or a return (referred to below as a “return”) indicating that no such conduct is known. The return may be either an “interim return” or a “final return”. An interim return is used where the IP expects to be able to submit either a report or a final return at a later date. If an interim return is filed and no unfit conduct has been discovered, the IP should file the final return (i.e., Form D2 final).
10. If the IP is unable to submit a report within six months and an interim return is submitted, the IP should indicate in the interim return the date by which he/ she expects to be able to submit a report or final return. If, for any reason, the IP subsequently finds that he/ she is unable to submit a report or final return by that date, he should notify the ORO as soon as possible. When fixing the date, the IP should bear in mind that any proceedings against a director must be issued within four years of the date of commencement of the winding up and that the OR needs time to evaluate cases and to prepare papers where action is to be taken.

¹ Refer to paragraphs 4 and 5 of LIGN (1) for the definition of an insolvency practitioner.

11. Where both events referred to in section 168I(2) of CWUMPO occur in respect of the same company, the four-year period runs from the date specified in relation to the earlier event. Accordingly, where an interim return has been filed, the IP should endeavour to submit a final return or a report well within the four-year time period.

Extent of Work

12. IPs are not expected to carry out detailed investigations regarding the conduct of directors, but to base their report, or decision that only a final return is necessary, on information coming to light in the ordinary course of their work.
13. LIGN (2) – *An insolvency practitioner's investigation into the affairs of an insolvent company*, describes the minimum level of investigation work that is expected of an IP.

Content of Reports

14. The following matters should be dealt with in the body of the report:
- The basis on which the IP considers a director's conduct to be reportable;
 - the position of any civil recovery actions against directors or former directors;
 - the adequacy of the accounting records;
 - professional advice taken by the directors, and specific correspondence which sheds light on directors' conduct, for example, with banks, solicitors, accountants or creditors.
15. Where an IP is unable to comment on the financial statements, due to cost or other considerations, then an explanation to that effect should be included in the report. An IP should consider not accepting an appointment if he/ she believes insufficient funds will be available to enable the IP's statutory and other investigatory responsibilities to be properly discharged.
16. As noted above, the Fifteenth Schedule to CWUMPO lists matters to which the court will have regard when considering a disqualification case. However, these matters are not exhaustive and an IP should include in the report other matters that the IP believes to be relevant.
17. The following items should, if appropriate, be appended to every report, where the information is available:
- A copy of the statement of affairs, or, where none has been submitted, the report should include an estimate of the financial position of the company by listing known assets and liabilities;
 - notes issued for purposes of the creditors' meeting (liquidations only), any original notes signed by directors from which the final issued note was prepared and any record of the proceedings at the meeting;
 - copies of accounts as available – the latest financial statements and the most recent management or interim accounts;
 - a summary of asset realisations, unrealised assets yet to be dealt with and claims notified;
 - dividend prospects;
 - an aged creditor analysis – if readily available;
 - evidence to substantiate any matters set out in the report.
18. An IP should form an overall view of a director's conduct when deciding whether a report is appropriate, rather than focusing narrowly on isolated technical failures.
19. It is helpful to include some details of the alleged failings where these are available (e.g., specific examples of lost customer deposits, as well as a total estimated figure of lost deposits). However, even if little substantive information is available, an IP should report on the basis of such evidence as does exist, bearing in mind the contents of paragraph 20, below. This may

help the OR build up a pattern to assist in deciding whether it is in the public interest for an action to be brought, either in the present case, or in the event of the director being involved in other insolvencies.

20. When fulfilling reporting duties, an IP should have regard to the laws of defamation and must be able to demonstrate that the reports were made after properly documented investigation.
21. Dictation of a report to, or discussion of it with, relevant staff of the IP's firm should generally be protected by qualified privilege. However, IPs should stress to staff and colleagues the importance of not disclosing reports, or their substance, to third parties, as the information is confidential and any such disclosure, unless directed by the court, could be prejudicial.
22. In preparing reports, the following are examples of matters that should be taken into account:
 - (a) attempted concealment of assets, cases where assets have disappeared, or a deficiency is unexplained;
 - (b) appropriation of assets to other companies for no consideration, at an undervalue, or on the basis of unreasonable charges for services;
 - (c) unfair preferences;
 - (d) personal benefits obtained by directors;
 - (e) overvaluing assets in accounts for the purpose of obtaining loans, etc., or to mislead creditors;
 - (f) loans to directors;
 - (g) dishonoured cheques;
 - (h) falsification of books and records;
 - (i) any breach of the Transfer of Business (Protection of Creditors) Ordinance (Cap. 49);
 - (j) situations where deposits are paid for goods or services, which, ultimately, are not supplied;
 - (k) cases where criminal convictions have resulted, or where reports had been made to the Commercial Crime Bureau or the Independent Commission Against Corruption;
 - (l) outstanding employees' entitlements; and
 - (m) deficiencies in accounting records.
23. IPs should note that the OR may require them to furnish such information regarding any person's conduct as a director, and to produce and permit inspection of books, papers and other records relevant to that person's conduct as a director, as the OR may reasonably require, in order for the OR to determine whether or not to apply to court for a disqualification order (section 168I(4), CWUMPO).

Personal Data (Privacy) Ordinance

24. IPs should acquaint themselves with the requirements of the Personal Data (Privacy) Ordinance (Cap. 486), the purpose of which is to protect the privacy interests of living individuals in relation to personal data. The ordinance is administered by the Privacy Commissioner for Personal Data. It provides exemptions from the "subject access" and "use limitation" requirements where the application is likely to prejudice certain competing public interests, including the prevention or detection of crime, and discharging the functions of a financial regulator. Whether or not these exemptions apply in particular circumstances will depend upon the facts of the case.

Liaison with the Official Receiver

25. IPs who require assistance or clarification regarding their investigations, or the completion of a report or return, should liaise with the OR. However, any such contact is informal and does not

affect the IP's responsibility for preparing the return or report in accordance with his/ her own judgement.

Costs

26. The submission of reports or returns, and the provision of information on the fitness of directors, are statutory duties that must be undertaken by any IP accepting a relevant liquidation (or receivership) appointment. The OR has no obligation to pay for such work, although the relevant costs are, in principle, payable out of the assets of the company, subject to obtaining any necessary approvals.