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Effective for insolvency appointments
made on or after 1 October 2005

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Insolvency Guidance Note (4) - Disqualification of directors – statutory reports

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

STATEMENT 1.603

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

(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. The IGN has been prepared for the sole use of members in dealing with statutory reports and returns on directors in connection with liquidations and receiverships 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 IGNs.
3. Members appointed as a receiver of a company or a liquidator are 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 Official Receiver ("OR"), concerning the directors of the company, within six months of appointment. The circumstances under which such documents are submitted are further outlined below.
4. In addition, members should note that there is a continuing obligation to report to the Official Receiver's Office ("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 discharge the liquidator's obligation. He must provide further information and reports to the ORO if additional information comes to light of which he might not have been aware when he first submitted the D-form (section 168I(3), Companies Ordinance).
5. The law regarding the submission of returns and reports and the disqualification of directors is contained in the Companies Ordinance and the Companies (Reports on Conduct of Directors) Regulation.
6. In addition, the OR has issued two memorandums elaborating on the requirements, ORO Circular No.1/2000 – *Prosecution* and Circular No.2/2000 – *Disqualification of Directors*, and members should refer to these for detailed guidance in completing returns or reports.
7. Members should note that the main provisions of Part IVA of the Companies Ordinance on disqualification of directors, and the Fifteenth Schedule, relate not only to directors/officers but also to "shadow" directors/officers, as defined in the relevant sections.

Content of Return / Report and Corresponding Time Limits

8. As outlined above, either a return or a report must be submitted within six months of appointment. The D-form will either be an adverse conduct report (subsequently referred to as a "report") giving details of conduct which may render the director unfit to hold office, or a return (subsequently referred to as a "return") indicating that no such conduct is known to the office-holder. The return may be either an "interim return" or a "final return". An interim return is used where the office-holder 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 office-holder should file the final return (i.e., Form D2 final).
9. If the office-holder is unable to submit a report within six months and an interim return is submitted, the office-holder should indicate in the interim return the date by which he expects to be able to submit a report or final return. If, for any reason, the office-holder subsequently finds that he 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 office-holder 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.
10. Where both events referred to in section 168I(2) of the Companies Ordinance 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 office-holder should endeavour to submit a final return or a report well within the four-year time period.

Extent of Work

11. Members appointed as liquidators or receivers are not expected to carry out detailed investigations regarding the conduct of directors, but to base their report, or decision that only a return is necessary, on information coming to light in the ordinary course of their work.

12. IGN (2) – *A liquidator's investigation into the affairs of an insolvent company*, describes the minimum level of investigation work that is expected of a liquidator.

Content of Reports

13. The following matters should be dealt with in the body of the report:

    - the position of any civil recovery actions;
    - 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.

14. Where a member 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. A member should consider not accepting an appointment if he believes insufficient funds will be available to enable him to properly fulfil his statutory and other investigative responsibilities.

15. The following items should, if appropriate, be appended to every report, where the information is available:

    - a copy of the statement of affairs: 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.

16. The Fifteenth Schedule of the Companies Ordinance lists matters to which the court will have regard when considering a disqualification case. However, these matters are not exhaustive and a member should include in his report other matters that he believes to be relevant.

17. A member 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.

18. 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, a member should report on the basis of such evidence as does exist, bearing in mind the contents of paragraph 19, below. This may help the OR build up a pattern to assist him 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.

19. When fulfilling his reporting duties, a member should have regard to the laws of defamation. He must be able to demonstrate that his reports were made after properly documented investigation.

20. Dictation of a report to, or discussion of it with, relevant staff of the member's firm should generally be protected by qualified privilege. However, members should stress to staff and colleagues the importance of not disclosing reports or their substance to third parties, as such disclosure is unlikely to be so privileged.

21. The OR welcomes receiving copies of the company's accounts and reports relating to the insolvency (e.g., the details presented to a meeting of creditors), where these are directly relevant or provide useful background information.

22. In preparing reports, the following matters 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 in making share purchases;

    (g) dishonoured cheques;

    (h) falsification of books and records;

    (i) phoenix operations;

    (j) misconduct in relation to operation of a factoring account;

    (k) situations where deposits are paid for goods or services, which, ultimately, are not supplied;

    (l) cases where criminal convictions have resulted, or where reports had been made to the Commercial Crime Bureau or the Independent Commission Against Corruption;

    (m) outstanding mandatory provident fund contributions; and

    (n) deficiencies in accounting records.

23. Members should note that the ORO may require the liquidator to furnish it with such information with respect to 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 ORO may reasonably require, in order for it to determine whether or not to apply to court for a disqualification order (section 168I(4), Companies Ordinance).

Personal Data (Privacy) Ordinance

24. Members 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. This ordinance is administered by the Privacy Commissioner for Personal Data. The ordinance 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. The OR encourages approaches from members who require assistance or clarification regarding their investigations or the completion of a report or return. However, such contact is informal and does not diminish the member's responsibility for preparing the return or report in accordance with his own judgement.

Costs

26. The OR has indicated that liquidators will be paid by the OR for any work undertaken at the request of the OR beyond that set out in IGN (2) – *A liquidator's investigation into the affairs of an insolvent compan*y. However, the scope of work to be undertaken and the costs must be agreed in advance.

27. 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 member 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.