

Insolvency news



Issue No 14

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Introduction

The 14th issue of Insolvency News contains a number of reminders about regulatory change, together with a range of articles including details of changes to monitoring arrangements, Practice Assurance and Continuing Professional Development.

In 2003, Insolvency Practitioners were given a number of opportunities to meet and discuss insolvency matters with members of staff of the Professional Standards Directorate. Four regional seminars were held in the autumn after the Joint Regulatory Conference in the summer. These were well received and some of the articles reflect the presentations and discussions held. Further seminars are planned for 2004 in some of the regional areas which were not visited this year.

SECTION A – REGULATORY ISSUES

1. Insolvency Regulations and Guidance

Don't forget that the amended Insolvency Regulations take effect from 1 January 2004.

Although this is unlikely to require any major changes in the way you conduct your business, make sure that you have the up-to-date version. A copy of the Regulations was sent to all licensed Insolvency Practitioners in October 2003.

New Regulations 3.12 and 3.13, concerning compliance reviews, have been deferred until 1 January 2005 and there are some further articles on this subject in this edition of *Insolvency News*. The existing requirement in Regulation 3.11 will apply until January 2005. This requires you to monitor the effectiveness of your own quality control procedures.

Copies of the revised Regulations can be downloaded from the Institute's website (www.icaew.co.uk/insolvency).

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2. Revised Ethical Statement 1.202 – The Practice of Insolvency

With effect from 1 January 2004, a standardised Insolvency Ethical Guide will be in place for all Insolvency Practitioners. The revised Guide is the first stage in a two-stage revision process.

For the first stage, changes were made to the current Guide:

- so that a standardised guide, which only required minor change, can be adopted by all of the licensing bodies;
- to reflect the appointment of nominees, in addition to supervisors of voluntary arrangements; and
- to include examples applicable to Scottish cases.

These changes should not materially affect the way in which Insolvency Practitioners conduct their business.

The second stage will entail a more comprehensive review of the Guide, looking at both the principles and the examples. If you or any practitioner wishes to raise an issue for consideration within that review, please email comments to alison.carr@icaew.co.uk and your comments will be passed on to the Joint Insolvency Committee (JIC) for consideration. It will not be possible at this stage for the JIC to reply individually to comments but they will all be considered.

The revised Ethical Guide will appear in the Members Handbook 2004. It is already available on the Institute's website (www.icaew.co.uk/insolvency).

3. Statement of Insolvency Practice 9 – Remuneration of Insolvency Office Holders – transitional provisions

A few enquiries have been received concerning the treatment of work which commenced before 31 December 2002, when version two of Statement of Insolvency Practice (SIP) 9 came into force.

Following discussions on this issue in the Joint Insolvency Committee, the licensing bodies have agreed that, for cases which commenced prior to 31 December 2002, any reports issued or resolutions taken after that date should comply with the new SIP. However, where any analysis or disclosure required for such a report or resolution relates to a period prior to 31 December 2002, it should comply with the new SIP as far as the available records reasonably allow.

Cases commenced after 31 December 2002 should follow the revised SIP.

A further review of SIP 9 is likely to be undertaken during 2004.

4. Money Laundering update

The laying before Parliament of the Money Laundering Regulations 2003 has been delayed. In the meantime, the Institute is in discussion with Government about various practical concerns with a view to finding workable and proportionate solutions before the regulations come into force. At the moment it is uncertain when the regulations will be laid before Parliament or when they will become effective. The Institute will provide formal guidance as soon as possible after the regulations have been laid. The January 2004 edition of *Accountancy* will include a large feature on money laundering. Members can find out the latest developments from the Institute's website (www.icaew.co.uk).

5. Professional Indemnity Insurance

Insolvency practitioners are reminded that it is a requirement to have professional indemnity insurance (PII) regardless of the status of licence held. All practitioners should ensure that they have suitable cover in place, which is in accordance with the Institute's PII Regulations. IPs are frequently covered by their firm's policy. However, practitioners should obtain their own cover if this is not the case.

For further information regarding PII, please contact the Regulatory Support team on 01908 546302.

6. Changes to the Joint Insolvency Examination Board examination requirements

Earlier this year, the Institute approached the Joint Insolvency Examination Board (JIEB) with a view to widening the access route for students to sit the JIEB examinations.

This coincided with the JIEB's own review of its operations which is still underway.

We are very pleased that the JIEB has agreed that it will no longer be necessary for students who are not full members of a Recognised Professional Body (e.g. Chartered Accountants or members of the Law Society) to join the Insolvency Practitioners Association or the Department of Trade and Industry Insolvency Service simply to apply to take the JIEB examinations.

With immediate effect, students will be able to apply to sit the examinations if they meet certain, specific criteria.

A student must have:

- been registered as a student of the ICAEW or a student of another licensing body for a minimum of 12 months immediately prior to sitting the examination.

Note: For most students, this will mean registering with the Institute as an independent student. Students can move across to the Institute having been registered with another licensing body. There are basic examination criteria which apply to those seeking independent student status and these are explained on the application form.

- been employed full time on insolvency for at least the previous 12 months within a firm where at least one of the principals is licensed by the ICAEW as an Insolvency Practitioner and that principal has been actively engaged in the work of an insolvency practitioner for the previous five years in this or another firm. The licence must enable the Insolvency Practitioner to accept appointments. Such a licence holder must have supervised the student's insolvency work during the previous 12 months.

Note: the student must have had at least one year's relevant work experience under the supervision of an experienced licence holder.

- completed the following three Professional Stage assessments in:
 - Taxation
 - Accounting
 - Commercial Law

or have been granted an exemption by the Education and Training Directorate under the Education and Training regulations for the award of exemptions.

Automatic exemptions are granted to members of the following bodies who have passed the appropriate papers as specified by the Accreditation Manager, Education and Training.

- ACCA
- ICAI
- ICAS

Exemptions will be considered on an individual basis for other qualifications on request.

Note: These three assessments (Taxation, Accounting and Commercial Law) can be taken by independent students.

Details of the assessments and the application forms are available on the Institute's website (www.icaew.co.uk/insolvency).

SECTION B – OTHER ISSUES

1. Insolvency affiliates – take a look at your firm

One change to the Insolvency Regulations has widened the range of individuals who can obtain their insolvency licence from the Institute.

Previously, only those individuals who were working in firms which were controlled by Chartered Accountants could become insolvency affiliates, but from 1 January 2004, this restriction will be lifted.

If you have any partners or staff who currently obtain their licence from another Recognised Professional Body (RPB) or the Department of Trade and Industry Insolvency Service, this may be the time to consider switching to the Institute. For Insolvency Practitioners in small firms, the annual licence fee could be as little as £870, which compares favourably with other regulators.

Before obtaining a licence, an individual who is not a member must become an affiliate of the Institute. A combined insolvency affiliate and licence application form is on the Institute's website (www.icaew.co.uk/insolvency).

Another reason for your colleagues to consider changing licensing body is the change to the monitoring arrangements for our Insolvency Practitioners to introduce a more holistic approach, (see Section 10.) We believe this will be just as effective as the current system but will be more cost effective and constructive for firms. If you or any of your colleagues would like to discuss obtaining a licence through the Institute, please contact David Kerr on 01908 546330 or Suzy Smyth on 01908 546262.

2. Compliance reviews – the requirements

As mentioned earlier in this newsletter, one of the changes to the Insolvency Licensing Regulations will not be effective until 1 January 2005. This relates to a change to the current Regulation 3.11 and the need to clarify the requirement for practitioners to monitor and review their own compliance with the regulations and that of others in the firm.

The existing Regulation 3.11 states that:

"A licence holder must monitor the effectiveness of his application of his own and/or his employer's quality control procedures."

The revised Regulations 3.12 and 3.13 which will be effective from 1 January 2005 state that:

3.12 *"A licence holder must make sure that there are adequate procedures and supervision in place to comply with these Regulations in relation to the conduct of*

insolvency work for which he is responsible."

3.13 *"A licence holder must review and record at least once a year, the effectiveness of his own and/or his firm's quality control procedures and compliance with these Regulations."*

These changes reflect the current requirements in the other regulated areas of Audit and Investment Business, which include a requirement for an annual compliance review.

The wording of the current Regulation has left some practitioners in doubt as to how and when they should conduct a review. The amendments and additional guidance should ensure that effective and regular reviews are carried out.

An annual compliance review (which may also form part of the firm's own wider quality assurance review) provides benefits for firms in enhanced quality control and also in time spent by the Institute and practitioners on compliance visits. Where a compliance review is found to be thorough and robust and appropriate action has been taken to resolve any issues identified, it can be used effectively to target monitoring resources during on-site visits.

The Institute will be providing help in many ways, both before and after implementation of the revised regulations in January 2005.

3. Compliance reviews – Key points and benefits

The previous edition of Insolvency News (No. 13) carries extensive commentary on compliance reviews. Key points to highlight are given below.

- A compliance review need not necessarily attract additional costs. As well as possibly outsourcing the work, the review could be conducted on an in-house basis or under a mutual arrangement with another practitioner.
- A compliance review is a tool for practitioners and firms, not only to look at purely regulatory issues but to consider the

firm's services, which may result in more effective provision of those services.

- If practitioners do not conduct effective compliance reviews or simply conduct a box-ticking exercise for another practitioner, the benefits of compliance reviews will be lost. A poor quality review will be of no benefit to the reviewed or the reviewer.
- Compliance reviews have been successfully used within the regulated areas of Audit and Investment Business over the past 12 years. The content of reports is made freely available to monitoring staff which helps create a more focused and effective monitoring visit. It is encouraging that some Insolvency Practitioners have already implemented similar successful reviews.
- The conduct of a compliance review and the disclosure of summaries or detail of the outcomes should not have any effect on a practitioner's Professional Indemnity Insurance. In fact, most proposal forms request information about compliance reviews/monitoring visit outcomes.
- The introduction of compliance reviews is sound practice management. Insolvency Practitioners within multi-partner firms may benefit from talking about the introduction of annual compliance reviews with fellow partners who have been subject to compliance reviews in connection with Audit Regulation for a number of years.
- Ultimately the review and re-performance of compliance reviews by monitoring inspectors should reduce the time spent on visits by inspectors and practitioners. This is not because the compliance review replaces part of the monitoring visit but because, where a monitoring inspector is satisfied that the firm and/or practitioner is conducting his or her own compliance reviews effectively, this will provide assurance to the monitoring staff and the licensing bodies and will allow monitoring to target more relevant or substantive aspects of a practitioner's work.

4. What is an annual compliance review?

The annual compliance review is usually undertaken in two parts. Firstly, it is a review of the firm's or office's compliance with its overall obligations (a whole office/insolvency department/internal control review) and secondly, "cold reviews" of completed work are undertaken.

To assist practitioners and firms, the Joint Insolvency Monitoring Unit (JIMU) has been developing a series of helpsheets and checklists and the latest draft versions of these checklists were made available to practitioners attending the recent regional insolvency roadshows. Copies of the draft are available from JIMU (Tel: 0208 681 8666). JIMU would be very pleased to receive feedback from practitioners on the drafts. Once finalised, the helpsheets and checklists will be available free of charge, initially on JIMU's website, with a link from the Institute's website.

The cold file review is an important part of the compliance review. It should be sufficiently challenging as to provide assurance to the Insolvency Practitioner that the quality control procedures which are built into a firm's insolvency processes are working satisfactorily and that the relevant regulations/rules are being complied with.

The whole firm/internal controls review can be carried out with the aid of a suitable checklist such as that produced by JIMU.

Practitioners are encouraged to use the helpsheets/checklists as pre-JIMU visit checks or, if practitioners have a circle of colleagues, to use them to review each other.

5. Do you work in isolation, even in a large firm? How will compliance reviews help?

There are 217 Institute firms with between 1 and 5 Insolvency Practitioners. Of these, 173 have only one Insolvency Practitioner in the firm. From a review of a number of monitoring reports, it appears that some practitioners are working in isolation even where they are in a multi-partner practice.

The Institute has anecdotal evidence that audit partners have little awareness of the issues identified during a monitoring visit to the firm's insolvency arm. Similarly, Insolvency Practitioners do not always know the outcome of a monitoring visit to the audit practice of a firm of which they are a partner. The regulated areas are not currently benefiting from improvements introduced in other areas as a result of monitoring or compliance reviews.

The Professional Standards Directorate has recently analysed the outputs of some monitoring visits undertaken in 2003 where both the audit and insolvency work were reviewed. The difference in standards has been quite marked, with the audit work generally showing a higher level of compliance with regulatory requirements. A possible reason for this divergence in standards is that the audit practice has been required to undertake compliance reviews on an annual basis since 1992. This has not been the case within the field of insolvency.

Insolvency Practitioners will benefit from considering how compliance reviews can be conducted across the full range of areas in which the firm works. Sole practitioners can consider working with other Insolvency Practitioners to undertake compliance reviews and to discuss relevant issues. Coupled with the Institute's new approach to monitoring, practitioners should see many benefits over the coming years.

6. News from the Insolvency Licensing Committee

We are now at the end of the second round of JIMU visits, so this is perhaps an appropriate time to draw your attention to some recurring issues seen in recent JIMU reports.

Case progression

The Committee has been particularly concerned about sometimes significant case progression issues. Whilst it is understood that there is a natural tendency to concentrate on new work, it is of course equally important to ensure that asset realisation and other issues on other cases are progressed on a timely basis. Clearly, in extreme cases, creditors can suffer a loss as a consequence of delay (for example, delay in collecting book

debts), and in cases where a dividend is likely, creditors may be affected by any undue delay in distributing funds.

Some of the issues noted by JIMU have arisen as a consequence of irregular and/or informal, and sometimes inadequate, case reviews. Generally, the Committee will expect file reviews to be carried out on a six-monthly basis, and to be seen by the office holder(s), although the frequency of reviews will depend on the circumstances of each case.

Practitioners are urged to ensure that they have in place procedures that provide for the regular review of cases, and that appropriate action is taken as a consequence of any matters arising from such reviews.

Annual returns

The Annual Return issued by JIMU is an important part of the monitoring process. Practitioners who fail to complete a return are in breach of the Insolvency Licensing Regulations and may find that the Licensing Committee imposes a regulatory penalty. The Committee takes a serious view of any such breaches, and any penalties proposed, or other regulatory action taken, will reflect this view.

Fees

The most common reason for the Licensing Committee imposing a regulatory penalty is unauthorised remuneration. Disappointingly, JIMU continues to have to report that fees have been drawn by practitioners, in some cases without the requisite approval from liquidation/creditors' committees, creditors meetings or the Court.

It is important that practitioners take great care to ensure that amounts are not withdrawn from insolvency estates without creditors having been consulted first. Practitioners should now be following the best practice guidance set out in the revised version of SIP 9 – Remuneration of Office Holders, which was issued this time last year and came into effect on 31 December 2002.

It is particularly important to remember that fees should not be drawn on the Official Receiver's scale without first seeking creditors' approval for

the basis of remuneration. Care should also be taken to ensure the validity of proxies received for, and resolutions taken at, meetings of creditors convened to approve fees. Practitioners are reminded that general proxies should not be used (in cases where the office holder is chairman of a meeting) to approve fee resolutions.

The new version of SIP 9 goes further than its predecessor in introducing, in certain cases, a requirement to provide more information to creditors. In theory, this will empower creditors to make a value judgement about the work done, and practitioners may find that creditors scrutinise fee applications more closely than before.

Complaints

The Institute recognises the time and effort that members devote to dealing with complaints. Insolvency, by the very nature of the work, tends to attract more complaints than is typical in other accountancy work. Many of these complaints prove to be unfounded and may be the consequence of misunderstandings about insolvency processes or disappointment at the outcomes of some cases. Often, with the benefit of explanations provided by members, the Professional Standards Office will be able to respond to complainants, and deal with the issues arising, without the need for any disciplinary action. Cases which do suggest some form of discreditable conduct will be referred to the Institute's Investigation Committee in the first instance. Members will always be given an opportunity to make written representations in respect of any matters considered by that Committee.

Members should have in place internal procedures for dealing with complaints; guidance can be obtained from the Members' Handbook, both on avoiding complaints in the first place and on handling those complaints that do arise from time to time. Members may also wish to seek help from the Members Support Scheme operated through the District Societies; a support member in each region provides confidential advice and support and is not bound by any duty to report misconduct.

The following suggestions may help members to minimise the impact of complaints.

- Review your internal procedures for dealing with complaints.
- Adopt an open approach in correspondence with complainants/the Institute.
- Use the support services if needed.
- Don't bury your head in the sand!
- Be professional at all times in dealing with complaints

Insolvency Practitioners may also benefit from ensuring that, in conducting an engagement, interested parties are aware of the role of the practitioner. This is a point noted by the Institute's Reviewer of Complaints who commented earlier this year that complaints can arise because of a lack of understanding on the part of the complainant about the role of the practitioner. The Reviewer will consider cases referred at the request of a complainant, where the Investigation Committee has decided there is no *prima facie* case to answer. His comments endorse the benefits of ensuring at an early stage that all parties are well aware of what the practitioner can and cannot do, in order to avoid later problems. The Institute is considering this point further in conjunction with the Joint Insolvency Committee.

7. Committee Appointments

Institute committees rely on the support of volunteer committee members who are prepared to give up some of their time to play an active part in the Institute's self-regulation process. The Insolvency Licensing Committee generally meets once a month to consider new applications for insolvency licences and the reports arising from monitoring visits to practitioners.

Meetings are generally held in London and the Institute welcomes enquiries from any member willing to serve on this or any other committee. Please write to Mr Les Smith, Head of the Executive Office, Chartered Accountants' Hall, PO Box 433, Moorgate Place London EC2P 2BJ.

8. Practice Assurance Update

Council's decision – At its meeting on 1 October, Council decided that all members who hold a Practising Certificate should fall within the ambit of the Practice Assurance scheme. This means that, if members vote in favour of Practice Assurance at the Special Meeting, the Institute's Practice Assurance scheme will cover **all** members in the **UK and abroad** who hold a Practising Certificate, **whether or not** they engage in public practice.

Fees – A fee will be charged to all Practising Certificate holders to cover the cost of monitoring. The fee will be collected at the same time as the Practising Certificate fee. The Practice Assurance fee is likely to be between £80 and £100. No charge will be made until January 2005.

Standards and Annual Return – The consultation period closed on 31 October. We are currently assessing feedback from members and are producing revised drafts of both documents to include the improvements suggested by practitioners. The Practice Assurance standards will be supported by helpsheets to enable firms to achieve compliance. These will be available in hard copy and online.

Pilot visits – Pilot visits to firms continue but we would welcome more volunteers. If you would be willing to take part, please call Heather Walker on 01908 546350 or email practiceassurance@icaew.co.uk. The results of pilot visits will be shared at roadshows in Spring 2004 and via articles in the accountancy press.

Articles – To find out more about Practice Assurance pilot visits, read the articles which appeared in the October and November editions of *Accountancy*. In October, a Midlands sole practitioner wrote about being on the receiving end of one of the first visits. In *Firm Friends* (November), Graham Bale and Trevor Smith discuss the visit process from the reviewers' perspective.

New booklet – A revised Practice Assurance booklet has been published entitled *Promoting Practice Quality*. This sets out final proposals for the scheme and has been sent to all members who hold a Practising Certificate.

Roadshows and video – The Institute has produced a Practice Assurance training video which will be shown to members attending roadshows in Spring 2004. Copies will also be circulated to all local district societies for use at other events and for loan to members. The video provides an overview of the scheme and also shows firms how they can complete their annual return online and gives them an insight into a Practice Assurance review visit.

Next steps

December 2003 to June 2004 – pilot visits continue

February 2004 to May 2004 – roadshows to explain the scheme in more detail

June 2004 – AGM, including vote on Practice Assurance

July 2004 – launch of dedicated area of website for firms

September 2004 – PA visits to firms already working in one of the regulated areas

January 2005 – PA visits to firms not working in one of the regulated areas.

For further information, visit www.icaew.co.uk/practiceassurance or email practiceassurance@icaew.co.uk or call Heather Walker on 01908 546350.

9. Continuing Professional Development (CPD)

A New Approach to CPD

As an Insolvency Practitioner you will be aware that CPE (as it is currently termed) is a compulsory professional obligation of your role. However, what you might not know is that this only applies to members in the regulated areas and to one or two other categories and not to the majority of the membership. Those members of the Institute working in the regulated areas (approximately a third of the membership) are subject to a points-based system and for Insolvency Practitioners that means 25 hours of structured training each year.

For some time now, CPD has been compulsory in the legal and actuarial professions and even financial advisers and insurers have compulsory CPD arrangements, but most of the accountancy profession has not had this requirement. These other professional groups all have to go through the annual requirement of demonstrating that they have met minimum CPD requirements to retain membership of their professional organisations. This principle is long established and most members of these groups see the requirement as a quid pro quo for the right to be able to use their professional designations after their names.

However, Chartered Accountants (other than those mentioned above) have not so far had such a requirement. They are able to trade on their qualification and inform the public that they are a Chartered Accountant and a member of a prestigious Institute, even though they may not have been keeping up to date with the requirements for their role.

This may be about to change. The Institute has just finished consulting on a principles-based approach to CPD with the founding principles including member wide coverage and monitoring. Other accountancy institutes, ICAS, CIMA, ACCA and in particular CIPFA are all considering making similar moves.

So what is this new approach? The use of a principles-based approach is key to much of the Institute's work and is being mirrored in the new CPD proposals. At its essence are the core values of professionalism, ethics and the exercise of professional judgement.

The approach focuses on individual professional development and the role that the Institute should play in supporting the membership in this, as opposed to a focus on compliance. It recognises that the imposition of a points-based target encourages compliance and not professional development, and that such a rule would conflict with a principles-based approach which emphasises the use of professional judgement.

Under the new plans, it is envisaged that the points-based system will be phased out and all members will adopt the new principles-based

system in which notching up a particular number of hours or scoring a certain number of points will not feature.

So what are the key features of the new approach?

- The new approach reflects what members do every day to meet the expectations of their role and profession.
- Professional expectations are defined as the exercise of professional judgement founded on ethics. In order to exercise professional judgement on an ongoing basis, members have to be aware of their business environment, the appropriate technical and regulatory frameworks and changes impacting on their role as well as the impact of their personal effectiveness.
- Rigour and relevance are ensured by promoting standards and expectations framed around key roles undertaken by the members in both regulated and non-regulated areas. Standards will be developed using the technical expertise of the Institute and the experience of the membership.
- Members will be required to consider, on an ongoing basis, the professional expectations that are placed upon them by many and various stakeholders and the changes that might affect expectations. They should identify and undertake appropriate development activities and consider the impact of what they have undertaken.
- There will be an explicit annual declaration .
- All 'active' members will be subject to monitoring. The monitoring will be sample-based. The sample will be risk-based. Monitoring will be based on review and will provide support, information and encouragement.
- Disciplinary proceedings will be followed where a member refuses to comply. It is expected that this will be in rare and extreme cases only.

It is envisaged that the monitoring of members operating in the regulated areas such as

Insolvency will continue to be as comprehensive and rigorous as at present.

The new approach to CPD will enhance the reputation of the Institute and its members. For reputation, read brand. It is incumbent on all members to maintain and enhance the brand's value. The Institute wants to place responsibility for competence firmly with an individual's judgement of what is expected in terms of skills and knowledge, and so increase public assurance that Chartered Accountants can demonstrate high ethical standards and professional expertise

As mentioned above, the Institute has recently completed an extensive consultation on the future shape of professional development. The response and feedback from the consultation is being analysed and used to develop proposals. If you would like a copy of the findings, please provide your email address or postal address to Laura Palmer. She can be contacted on 01908 248293 or email cpdconsultation@icaew.co.uk.

In an age where the public is demanding greater accountability across the professions, the issues raised by the consultation will help forge a link between what it means to be a professional and CPD.

10. Changes to the monitoring arrangements

At its meeting in March 2003, the Institute's Council decided that it will conduct its own insolvency monitoring. This will take effect from January 2005.

We envisage that this will provide a number of benefits for Insolvency Practitioners.

- A more holistic approach will be adopted to monitoring. Where the Insolvency Practitioner is within a mixed practice, we will avoid duplication of monitoring in areas which overlap. If Practice Assurance is introduced, an insolvency monitoring visit will be conducted in conjunction with that visit. This will reduce the number of visits a firm will receive.
- The technical skills of experienced insolvency professionals will continue to be

used but they and you will benefit from their involvement in a team of mixed professionals.

- The new approach to visits will be more cost effective.

There will be no change to the high standards and expertise currently exemplified by JIMU. Insolvency professionals will visit your firm; they may consider other areas of your firm under Practice Assurance, or they may be joined by other members of the Quality Assurance Directorate, depending on the structure and activities of your firm.

11. Small Firm Rescue: An Analysis of Company Voluntary Arrangements

by Gary A.S. Cook,

Naresh R. Pandit, David Milman and Carolynne Mason

The Institute has recently published the above research on small firm rescue. A copy of the research paper is available for purchase from the Centre for Business Performance and details are on the website, www.icaew.co.uk/cbp. The following article has been prepared by the authors of the research.

The Company Voluntary Arrangement (CVA) procedure was established by the Insolvency Act 1986 to provide means for the turnaround of financially troubled, but viable, small firms. Early hopes for the CVA as a rescue vehicle stand in marked contrast to the procedure's take-up and perceived success, both of which have been disappointing. This research is based on a postal questionnaire survey sent to all licensed Insolvency Practitioners during 2001/2 and a set of in-depth interviews with insolvency practitioners, company directors, expert commentators and other interested parties. The research also draws on a previous survey of CVAs (Milman and Chittenden 1995)¹ and Companies House records.

The characteristics of companies that use CVAs

One of the most striking findings is that in around half of the cases in our questionnaire survey, the main purpose of the CVA was to

¹ Milman, D. and Chittenden, F. (1995), *Corporate Rescue: CVAs and the Challenge of Small Companies*, ACCA, London

conduct an efficient wind up of the business. Many of the Insolvency Practitioners interviewed felt that this was a legitimate use of the procedure as long as it resulted in a higher return to the creditors. Although CVAs are not concentrated in a particular sector of the economy, the procedure is predominantly used by small companies. The majority of debt owed by these companies is to unsecured creditors, a level which, on average, is over twice that owed to secured creditors and over eight times that owed to preferential creditors. Companies that go into CVAs usually have many problems: in over half of cases, five or more causes of financial difficulty are present, although it is typical for a particular cause to dominate. The single most important cause is poor management.

Key advantages of the CVA procedure

The CVA emerges as being a successful regime along a number of dimensions. All classes of creditor receive good dividends when compared to other insolvency regimes, especially unsecured creditors. The rate of company preservation is good. A key strength of the CVA procedure is its flexibility. Many Insolvency Practitioners emphasised the value of being able to negotiate bespoke arrangements with creditors, allowing them to use their professional skill and experience to fashion workable and acceptable proposals. Another important advantage is the lower cost of the CVA. In some cases, the confidentiality of the CVA procedure can also be an important advantage, especially where retaining customer confidence is important.

Factors conducive to CVA success and failure

Insolvency Practitioners play a highly important role in the success of CVAs. Practitioners can contribute to the prospects of a successful outcome by ensuring a realistic cash flow forecast as the basis for the proposal. Larger accountancy firms propose lower dividends but pay a higher proportion of the proposed dividend. It is important for Insolvency Practitioners to be frank with creditors regarding the prospects for the business and also to keep them properly informed during the process of the CVA. Otherwise, creditors are likely to feel they are being taken advantage of and withdraw support. There is some evidence that turnaround plans are more successful when the CVA is entered via administration. Also,

successful outcomes are positively related to company size and company age.

Unsuccessful CVA outcomes are most strongly related to the adverse actions of unsecured creditors, defections of customers, the inability to restore profitability and continuing poor management.

Barriers to the use of CVAs

A key reason for not using CVAs more widely for turnaround is simply a lack of suitable cases, not least due to perennial problems of directors of distressed companies coming forward too late for effective rescue to be feasible. An important barrier is that only a small proportion of Insolvency Practitioners have any experience with CVAs. Practitioners worry about whether it is realistic to forecast cash flows up to five years ahead and also whether they will expose themselves to significant amounts of work up front, trying to arrange a CVA, only for the proposal to founder. Insolvency Practitioners are dubious about taking on CVA cases where the recovery plan depends on improved management. Finally, the CVA is hindered by a general perception that it does not work, in part, due to the activities of 'cowboy' Insolvency Practitioners and turnaround specialists. Whilst some of these problems have been tackled, the CVA is still hindered by perceptions of poor practice in the past.

Problems arising during CVAs

Once a CVA is underway, a number of problems can arise. One, that was frequently cited, was continued poor management, an inherent weakness of any "debtor-in-possession" insolvency regime. It is very difficult for supervisors of CVAs to address problems of poor management due to their limited powers. Suppliers can impose onerous terms such as 'cash on delivery', or they can raise prices or, in the worst case, withdraw supply all together. There were also instances of companies in CVAs finding it difficult to raise additional finance for investment purposes thereby jeopardizing the recovery plan. Loss of customer confidence was also cited.

Key policy recommendations

CVAs already work well, particularly in the hands of experienced Insolvency Practitioners and with

sophisticated creditors. Nevertheless, some proposals emerge from the report regarding how CVAs could be made to work better.

There is a general need to inform interested parties of the full menu of insolvency procedures, including the CVA procedure. The relevant professional bodies need to work on better informing their members while a simple, widely available guide produced by the government would be a step in the right direction for directors, creditors and other stakeholders.

Related to this, it is clear that practice in the proposal and conduct of CVAs had improved over time as Insolvency Practitioners have gained experience. There is a need for wider dissemination of examples of such good practice. Further action needs to be taken to encourage directors to come forward sooner through training and legal incentives. Finally, there is a need to address the unfavourable image of CVAs in some quarters. Hopefully, this report goes some way to addressing these issues.

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