



## **STATEMENT OF INSOLVENCY PRACTICE 2 (Scotland):**

### **A LIQUIDATOR'S INVESTIGATION INTO THE AFFAIRS OF AN INSOLVENT COMPANY**

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**Effective from 1 April 2007**

## **INTRODUCTION**

1. This Statement of Insolvency Practice (SIP) is one of a series of guidance notes issued to licensed insolvency practitioners with a view to maintaining standards by setting out required practice and harmonising practitioners' approach to particular aspects of insolvency.

SIP 2 (Scotland) is issued under procedures agreed between the insolvency regulatory authorities acting through the Joint Insolvency Committee (JIC). It was commissioned by the JIC, produced by the Association of Business Recovery Professionals, and has been approved by the JIC and adopted by each of the regulatory bodies listed below:

Recognised Professional Bodies:

- The Association of Chartered Certified Accountants
- The Insolvency Practitioners Association
- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants in Ireland
- The Institute of Chartered Accountants of Scotland
- The Law Society
- The Law Society of Scotland

Competent Authority:

- The Insolvency Service (for the Secretary of State for Trade and Industry)

The purpose of SIPs is to set out basic principles and essential procedures with which insolvency practitioners are required to comply. Departure from the standard(s) set out in the SIP(s) is a matter that may be considered by a practitioner's regulatory authority for the purposes of possible disciplinary or regulatory action.

SIPs should not be relied upon as definitive statements of the law. No liability attaches to any body or person involved in the preparation or promulgation of SIPs.

- 1.2 In all liquidations, the liquidator has a duty to investigate the company's affairs.

## **THE LIQUIDATOR'S DUTY**

2. A liquidator's function is to get in the assets of the company and distribute them to the creditors. To that end he has a duty to investigate what assets can be realised and what other recoveries can be made. The creditors have an interest in the liquidator's investigations, because both the level of recoveries and the costs of the investigations will directly affect the funds available for distribution to them. When considering the scope and detail of his investigations the liquidator should therefore bear in mind their impact on the creditors' interests. He should, subject to the considerations set out in paragraphs 7 to 11, maintain appropriate communication with the creditors to ascertain their views about actual and prospective investigations, and to keep them informed of their progress and likely outcome. The liquidator also has a reporting responsibility with regard to the conduct of the directors under the Company Directors Disqualification Act 1986.

## RECORDS

3. At the outset of his appointment the liquidator should ascertain the location and safeguard and list the company's books (including the statutory books and minutes), records and other accounting information (including computerised records). If the liquidator encounters non-co-operation he should clearly record the steps taken by him.

## INITIAL REVIEW

4. At the outset of the liquidation the liquidator should conduct an analytical review, based on the initial information available, in order to assess whether there is a prima facie case for further, more detailed, investigation into any aspect of the company's affairs. In order to carry out this review the liquidator should undertake the following preliminary enquiries:
  - 4.1 Where a creditors' meeting is held under section 98 of the Insolvency Act 1986, the liquidator should, both at the meeting and in the subsequent report to creditors, invite creditors to bring to his attention any particular matters which they consider require investigation. Where there is a liquidation committee, the liquidator should also specifically invite members of the committee to bring to his attention any matters requiring investigation. A copy of this statement of insolvency practice, or information on where it may be accessed, should be made available to liquidation committee members.
  - 4.2 The liquidator should make enquiries of the officers of the company and other senior officials as to the company's affairs, including the reasons for failure and the location of its records and property. If the liquidator encounters non-co-operation he should clearly record the steps taken by him.
  - 4.3 The statement of affairs should be compared with the last audited, filed or management accounts in order to ascertain whether all significant fixed and current assets can be identified and material movements in fixed and current assets can be properly explained.
  - 4.4 The liquidator should conduct a preliminary review of the books, records and minutes for the last six months in order to identify any unusual or exceptional transactions.
5. The liquidator should consider whether the initial review discloses any matters that suggest there are grounds for more detailed investigation, or possible rights of action which the company or the liquidator may have against third parties. In conducting this exercise the liquidator should have regard to the size of the case, the level of assets available to fund any further investigations or actions, and the materiality of the matters disclosed.
6. Where the liquidator has previously been instructed to assist the directors in putting the company into liquidation and convening the creditors' meeting, some of the work contemplated at paragraphs 4.2 – 4.4 may have been done in advance of the liquidation. Where this is not the case, it should be undertaken as soon as possible

after the liquidator's appointment.

## **CONSULTATION WITH COMMITTEE/CREDITORS**

7. Where the liquidator believes there are grounds for further investigation or possible action, he should discuss the matter with the liquidation committee in order to ascertain and assess their views on such further work. This assessment will need to take into account the possible benefit to the estate and the likely costs of the exercise. The liquidator should provide the committee with any information they may reasonably require to enable them to provide their views.
8. If the liquidator decides that further investigation should be undertaken, the liquidator should discuss the scope of the work and funding issues with the committee. In the case of a potential action, account will need to be taken of the availability of adverse costs insurance.
9. The liquidator should report to the committee on the progress of the investigation at specified intervals or at appropriate stages during the conduct of the investigation. When reporting, the liquidator should provide details of the costs incurred to date, and should seek the views of the committee on the continuation of the investigation.
10. It will be easier for the liquidator to consult with the creditors where there is a committee. Where there is no committee the liquidator should seek the views of the creditors either by correspondence or by way of a creditors' meeting, or, where this is impracticable, by discussion with the major creditors.

## **MATTERS FOR DETAILED INVESTIGATION**

11. Where it is agreed to conduct further investigations, the following points may usefully be borne in mind, depending on the circumstances of the case and the nature of the investigations:

- **Questioning directors and other key personnel –**

The question of which individuals are relevant to the liquidator's investigations is likely to depend on the information which the liquidator believes they may hold. The individuals who may be relevant will normally include:-

- a) all directors (by whatever name called), including directors who held office during the three years prior to the liquidation,
- b) the company secretary,
- c) other senior officials and employees,
- d) the company's professional advisers,

but may also include others from among the persons listed in section 235(3), or who come within the ambit of section 236, of the Insolvency Act 1986. Members may find it useful to issue questionnaires to obtain factual information.

- **Statutory books and minutes –**

In most cases where further investigation is deemed appropriate, the statutory books of the company, including the minute book, should be examined and compared with a search obtained from Companies House. Particular attention should be given to the identity of directors who held office during the three years prior to the liquidation.

- **Records –**

Can changes in the financial position of the company be satisfactorily accounted for from the records of the company (including, inter alia, bank statements) covering the period since the date of the last audited or filed accounts, or if none since the incorporation of the company? Is there is a material difference between the deficiency disclosed in the statement of affairs and the last audited or filed accounts, or, if none, since the last management accounts or since the incorporation of the company, after taking into account matters such as writing down asset values? If so, consideration may be given to the preparation of trading and profit and loss accounts for the final trading period.

- **Validity of charges –**

If the company has granted any charges, do the circumstances of the case render it appropriate or necessary to consider the validity of such charges or the validity of any receiver purportedly appointed pursuant to such charges?

- **Transactions with associated companies or connected persons –**

Have there been any transactions with associated companies or connected persons (as defined in sections 435 and 249 respectively of the Insolvency Act 1986)? If so, the books and records of the company should be examined to ensure that they were carried out at arm's length, and material transactions should be examined in detail. Particular attention should be paid to transactions involving directors, including any reduction in loan accounts, overdrafts or other debts supported by personal guarantees.

Have there been any transactions (other than in the ordinary course of business) between the company and any company of which it is an associate during the period of two years prior to the resolution of the directors that the company be wound up? If so, the liquidator should satisfy himself as to the validity of the transactions. He should similarly satisfy himself in relation to any transactions with any one or more of its directors or any other associate of him or them during the same period. In addition, the liquidator should have special regard to any information supplied by creditors or others which concern transactions between directors and associated companies or connected parties.

## **GENERAL**

### **Rights of action**

12. The liquidator's investigations may disclose possible rights of action which the company or the liquidator may have against third parties. Rights may arise, for

example, under the following provisions, though this list is not exhaustive:

### **Insolvency Act 1986**

Section 76	Redemption or purchase of own shares
Section 127	Avoidance of property dispositions etc.
Section 128	Avoidance of attachments etc.
Sections 150 and 165	Uncalled capital
Section 212	Summary remedy for misfeasance and misapplication etc. of property
Sections 213 and 215	Fraudulent trading
Sections 214 and 215	Wrongful trading
Section 242	Gratuitous alienation (NB also gratuitous alienation at common law)
Section 243	Unfair preference (NB also fraudulent preference at common law).
Section 244	Extortionate credit transactions
Section 245	Avoidance of floating charges

### **Companies Act 1985**

Sections 135 to 141	Unauthorised reduction of capital
Sections 151 to 181	Unlawful assistance/redemption in the purchase of own shares
Section 277	Unlawful distributions to members
Sections 320 - 322B	Unlawful property transactions
Sections 330 - 341	Unlawful loans

### **CRIMINAL OFFENCES, DIRECTORS' DISQUALIFICATION AND OTHER MATTERS**

13. It is not the duty of a liquidator to investigate criminal conduct, but if it should come to his notice 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 he is criminally liable, then in a winding up by the court, the court may direct the liquidator to make a report to the Lord Advocate. The court can do this on its own motion or on the motion of anyone else interested in the winding up. In a voluntary winding up the liquidator must report to the Lord Advocate. (Insolvency Act 1986, section 218).
14. In the case of an insolvent liquidation, the liquidator must report forthwith to the Secretary of State on the conduct of any past or present director where it appears to him likely that the Court will find that the conduct of that director makes him unfit to be concerned in the management of a company (Company Directors

Disqualification Act 1986, section 7(3)). The liquidator must also submit a return to the Secretary of State within 6 months of the liquidation in relation to any director for whom a finding of unfitness is unlikely to be made.(Insolvent Companies (Reports on Conduct of Directors) Rules 1996 Rule 4) For this purpose the liquidator is only required to consider matters which come to his attention during the ordinary course of his work, but he has an additional duty to supply such further information as the Secretary of State may reasonably require under S 7(4) Company Directors Disqualification Act 1986.

15. Liquidators should also bear in mind their reporting duties under other legislation.

**Effective date 1 April 2007**