

Insolvency procedures, forensic investigations and directors' duties

Presentation to STEP Guernsey

10 January 2022





Agenda

- **Insolvency**
 - Solvency definition; indications of insolvency; other reasons to wind-down a company; insolvency 'Twilight Zone'; insolvency options; changes proposed; directors duties regarding insolvency; governance
- **Forensic investigations**
 - Types of investigations; things that go wrong; fraud definition; occupational fraud; financial and other cost; why should directors consider fraud?; fraud prevention checklist





Solvency definition

Jurisdiction	Definition
Guernsey – ‘Solvency Test’	<ul style="list-style-type: none">• Able to pay debts as they become due (statutory demand process available)• Value of company’s assets greater than value of liabilities
Jersey - ‘Insolvent’	<ul style="list-style-type: none">• Inability to pay debts as they fall due
UK – ‘Insolvency’	<ul style="list-style-type: none">• Unable to pay debts as they fall due (statutory demand process available)• Value of assets less than value of liabilities
Luxembourg – ‘Bankruptcy’	<ul style="list-style-type: none">• Unable to pay debts as they fall due• Can no longer raise credit
French – ‘Insolvency’	<ul style="list-style-type: none">• Unable to meet current due debts with immediately available assets

Indications of insolvency

- Illiquidity / cash flow
- Material changes / subsequent events
- Contingent liabilities
- Group entities / balances – look wider
- Non balance sheet items
- Other 'red flags' e.g. incomplete audit; annual validations



Indications of insolvency - considerations



Concern

Asset values uncertain in distressed market

Debts collectable?

Currency stability

Contingent liabilities emerging/ crystallising

Inter-company/ trust balances become unstable



Mitigation

Current re-valuation with note on any difficulty to realise

Check & document collectability; realistic % to be collected; make provisions

Hedging or exposure provision

Check for warranties or guarantees given and exposure

Check realisable/ collectable or danger to wider structure

Indications of insolvency - considerations



Concern

Trading entities going concern?

Guarantees reliable?

Secured lender threatening legal action

Assets unmatched by liabilities

Lack of current cash flow/ accounts



Mitigation

Understand the underlying business and any future cash requirements to maintain trading/ threaten insolvency

Check strength of any guarantees from third parties

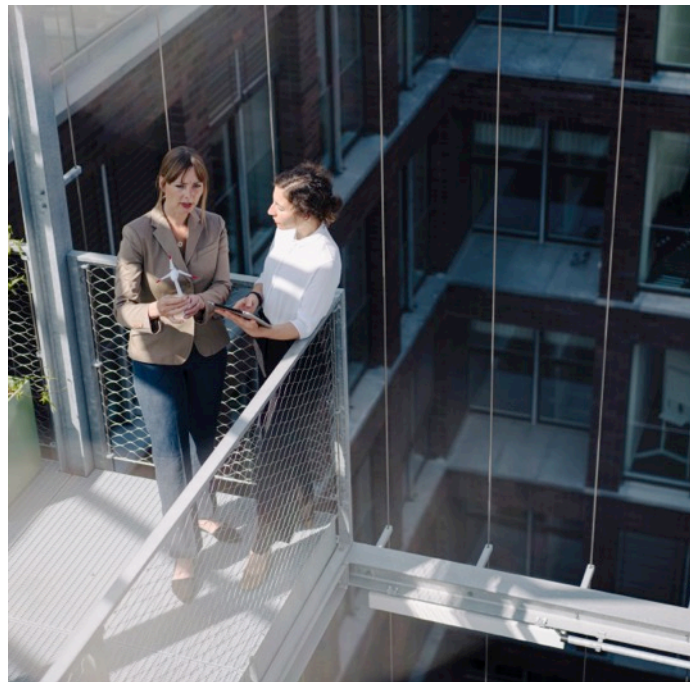
Check position and take advice to mitigate losses if required

Ensure assets are understood

Produce for board review

Other reasons to wind-down a company

- Company has fulfilled its economic purpose
- Avoid cost of retaining company e.g. audit
- Group consolidation
- Tax planning
- SPV which has no assets
- Fund that has closed



Insolvency 'Twilight Zone'



Concern



Mitigation

Legal status

'Insolvency' defined differently depending on jurisdiction of company

Understand the law for the company's jurisdiction. Take advice

Creditors

Directors' fiduciary duties change to creditors not shareholders

Minute that this is understood

Options available

Restructuring options need to be understood together with timescale before they narrow

Document options. Preserve cash to keep options open

Insolvency options

- Compulsory winding up
 - Court appointment
- Voluntary winding up
 - Solvency?
- Administration
 - Rescue process



Changes proposed

- Companies (Guernsey) Law, 2008 (Insolvency) (Amendment) Ordinance 2020
 - Distinguishes between solvent and insolvent liquidation
 - Addresses lack of independence for Liquidators
 - Greater creditor consultation
 - Obligation to report director misconduct to Registrar and Regulator
 - Greater powers to pursue recoveries for creditors



Director duties regarding insolvency

- Professional directors higher test of competence
- PII / D&O concerns
- Record concerns
- Independent advice at board level
- Financial support available?
- Winding up
- Consequences – antecedent transactions; wrongful/fraudulent trading; personal liability; regulatory sanction; disqualification



Governance



Concern

Board

Board meetings not / improperly held

Board of directors not really in control



Mitigation

Hold real board & trustee meetings –fully minuted

One board only, minimal delegation of functions

Documentation

Lack of documented solvency monitoring

Attach evidence of work to understand true asset and liability values and cash flow to board minutes

Governance



Concern

Understanding

Lack of understanding of changed priorities for directors



Mitigation

Independent advice; proper director training

Dangers / Risk

Ignorance of the dangers of insolvency risk

Independent professional advice attending board & trustee meetings

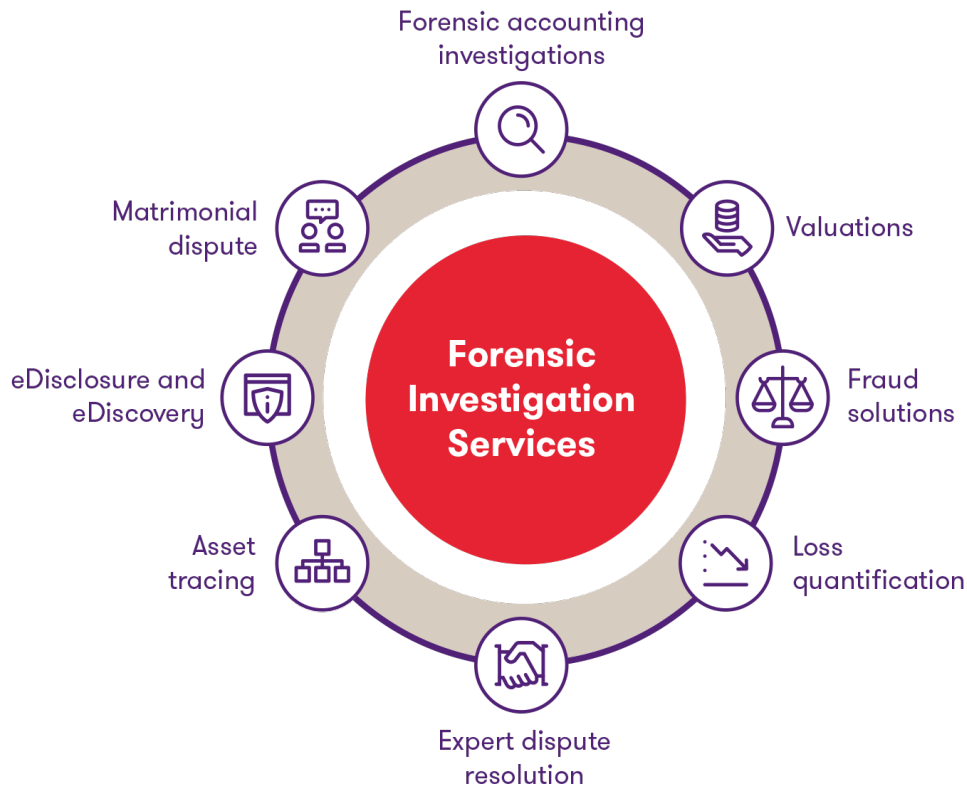
Due consideration

Decision not given proper deliberation

Ensure that they are given proper deliberation

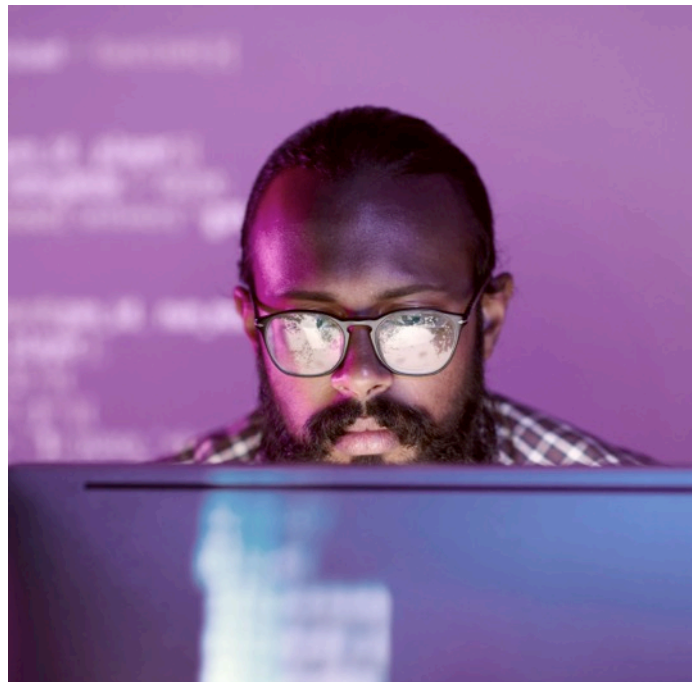
Forensic investigations

- Various types of forensic investigations – not just fraud related
- Often linked to insolvency



Things that go wrong

- **Potential problems can include:**
 - Compliance failures – highest incident
 - Dispute between parties e.g. Trustee and beneficiaries
 - Litigation and legal disputes
 - Mistakes
 - Tax enquiries
 - Fraud





Fraud definition



A knowing
misrepresentation
of the truth or
concealment.

Black's Law Dictionary



Abuse of position, or
false representation,
or prejudicing
someone's rights for
personal gain.

Serious Fraud Office



Wrongful or
criminal deception
intended to result in
financial or
personal gain.

Oxford Dictionary

Occupational fraud - examples

- Asset misappropriation e.g. theft of cash; skimming of receivables; transfer of assets; theft of stock
- Fraudulent disbursements e.g. falsified wages; 'ghost employee'; fictitious expenses
- Financial statement fraud e.g. improper asset valuations; understated revenue/overstated expenses
- Corruption e.g. invoice kickbacks; illegal gratuities



Financial cost

- Typical organisation loses 5% of revenue to fraud each year
- Figure translates to a potential annual fraud loss of nearly \$4 trillion
- Median loss of \$130k; 22% of cases losses of \$1m+
- 53% of organisations do not recover any losses

The 2018 Report to the Nations on Occupational Fraud and Abuse: ACFE Global Fraud Study



Other costs

- Reputational costs
- Stakeholder relationships
- Decreased morale/productivity

*The 2018 Report to the Nations on Occupational Fraud and Abuse:
ACFE Global Fraud Study*





Why should directors consider fraud?

- The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.
- Relevant Laws of the Bailiwick of Guernsey:
 - *Theft (Bailiwick of Guernsey) Law, 1983* – it is an offence to obtain pecuniary advantage by deception, evasion of liability by deception and false accounting
 - *Forgery and Counterfeiting (Bailiwick of Guernsey) Law, 2006* – forgery is an offence (i.e. using or copying a false instrument)
 - *The Companies (Guernsey) Law, 2008, s. 432* – every person who is knowingly party to the carrying on of a business with the intention to defraud creditors (whether of the company or any person) is guilty of an offence.
 - *Fraud (Bailiwick of Guernsey) Law, 2009* – a person is guilty of fraud if they commit fraud by false representation, by failing to disclose information or by abuse of position (max. 12 years imprisonment)

Fraud prevention checklist

1. Anti-fraud training
2. Fraud reporting mechanism
3. Employee perception of detection
4. Management culture: honesty and integrity
5. Fraud risk assessments
6. Anti-fraud controls





Fraud prevention checklist – cont.

- 7. Internal audit resources/authority
- 8. Hiring policy
- 9. Employee support programmes
- 10. Open-door policy
- 11. Anonymous surveys on employee morale

Association of Certified Fraud Examiners



Questions

