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Northern Ireland Audit Office

Insolvency and the Conduct of Directors

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HC 816, Session 2005-06, 2 February 2006

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Report by the Comptroller and Auditor General for Northern Ireland

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J M Dowdall CB
Comptroller and Auditor General

Northern Ireland Audit Office
31 January 2006

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Abbreviations

DDU	Directors' Disqualification Unit
DETI	Department of Enterprise, Trade and Investment
GB	Great Britain
IP	Insolvency Practitioner
IPCU	Insolvency Practitioner Compliance Unit
IS	Insolvency Service
NAO	National Audit Office
NI	Northern Ireland
NIAO	Northern Ireland Audit Office
OR	Official Receiver
PAC	Public Accounts Committee
PAYE	Pay As You Earn
RPBs	Recognised Professional Bodies
VAT	Value Added Tax

Glossary of terms

Affidavit	An affidavit is a written statement of evidence made under oath. An application for a disqualification order is made by originating summons, supported by evidence in the form of an affidavit from the Insolvency Practitioner or Official Receiver and a grounding affidavit sworn by a senior examiner from the Insolvency Service.
Company Insolvency	A company is insolvent if its assets are insufficient to pay its debts, liabilities and winding-up expenses. A company becomes insolvent for disqualification purposes if it goes into liquidation; or an administration order is made by the Court to appoint an administrator to take control of the company; or an administrative receiver is appointed by a secured creditor or the Court to take control of the company's assets – the disqualification procedures are the same in each case.
Insolvency Practitioner	A person, usually an accountant or solicitor, who specialises in insolvency. They are authorised either by the Department or by one of a number of recognised professional bodies. They are appointed to act in voluntary insolvencies and other insolvency procedures under the insolvency legislation.
Limited liability status	A company is said to be incorporated with limited liability where it is responsible for its own debts and the liability of shareholders is limited to their commitment on their personal shareholdings.
Liquidation (Voluntary and Compulsory)	The winding up of a company with the sale of its assets and, if sufficient proceeds, the payment of the company's debts. In a Voluntary Liquidation the shareholders pass a resolution to appoint a liquidator. A Compulsory Liquidation results from a Court Order.
Net Deficiency	The difference between the value of the assets owned by a company and the money owed by it at date of winding up.
Official Receiver	Civil servant within the Insolvency Service (employed by the Department) who is also an officer of the High Court and whose principal functions relate to bankruptcies (individual insolvencies) and compulsory company liquidations.

Public Interest	The legislation provides for the Courts to disqualify directors of insolvent companies in the 'public interest' if they have shown 'unfit conduct'. There is no definition in the legislation of public interest, but it is accepted by the Courts that there is a public interest that those who are unfit to be company directors should be disqualified.
Relevant date	The Insolvency Service has two years from the 'relevant date' to apply for a disqualification order or obtain a director's undertaking not to act as a company director. The relevant date is the date of the Court Order in a compulsory winding-up; the date of the shareholders resolution in a voluntary winding-up; the date of appointment of the administrative receiver in an administrative receivership; and the date of the administrative order in an administration – typically this co-incides with the appointment of the practitioner.
Unfit Conduct	Includes, among other matters, the extent of the director's responsibility for failure of the company to supply any goods and services which have been paid for, failure of the company to keep accounting records, and failing to co-operate with the liquidator - defined in Schedule 1 of the Companies (NI) Order 1989 – see also Appendix 1.
Recognised Professional Bodies (RPBs)	Professional Bodies recognised by the Department for the purposes of authorising Insolvency Practitioners, ensuring they are 'fit and proper' to work in insolvency and assuring their education, practical training and experience.

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Executive Summary

Background

1. At March 2005, there were some 30,000 companies registered in Northern Ireland and approximately 155,000 directorships within those companies. Around 135 companies become insolvent (where a company's debt and liabilities exceed its assets) each year. The legislation provides for directors of insolvent companies to be disqualified, for between two and 15 years, if there has been 'unfit conduct' by them. Unfit conduct includes negligence, incompetence or lack of commercial integrity.

2. Over 99 per cent of registered companies in Northern Ireland have 'limited liability' status, where the shareholders (in most cases) are not personally liable for debts should their company subsequently fail. The aim of the legislation is to deter abuse of limited liability status and to protect future creditors from the actions of unfit directors. The Department of Enterprise, Trade and Investment (the Department) has pointed out that the legislation cannot and does not, in itself, attempt to prevent insolvencies. Over the period from October 1991 (when new legislation was implemented) to March 2005, there were some 1,790 company insolvencies in Northern Ireland. The combined net losses to creditors were approximately £330 million in total – some £24 million per year (paragraphs 1.1 – 1.3).

The Insolvency Service

3. The Insolvency Service is an operational unit within the Department and is the main body responsible for administering the legislation on directors' disqualification. It promotes and seeks to maintain the integrity and working of the market place by administering and investigating the affairs of bankrupts and companies in compulsory liquidation. Through its regulatory role it aims to drive up the standards of corporate and commercial behaviour.

4. The identification and reporting of directors' unfit conduct is undertaken by the Official Receiver (OR) or by private sector Insolvency Practitioners. The OR is a civil servant within the Insolvency Service and an officer of the High Court. He is responsible for administering and investigating all *compulsory* liquidations (where companies are wound-up by the courts). He and his staff must investigate the conduct of directors involved in compulsory liquidations and provide a report on their findings. Insolvency Practitioners, generally qualified accountants or solicitors, are appointed to act in *voluntary* liquidations, administrations and receiverships (where companies are wound-up by shareholders or creditors) and are required to report to the Insolvency Service on any suspected unfit conduct by directors which they become aware of in the normal course of the insolvency. The Insolvency Service's work is designed to reduce the likelihood of future insolvencies which might arise as a result of misconduct by directors of a previously failed company. Since October 1991, there have been 118 disqualification orders from the courts covering 209 directors and 'undertakings' from 33 directors not to act as directors (paragraphs 1.4 to 1.8).

The Scope of NIAO's Examination

5. The scope of our examination covered:

- the effectiveness of Insolvency Practitioners and the Official Receiver in assessing directors' conduct
- the performance of Insolvency Service in taking unfit conduct cases
- the extent to which the Insolvency Service is engaging with key stakeholders.

During the study, we undertook surveys of 200 company directors and the 48 Insolvency Practitioners licensed to operate within Northern Ireland. To assist in the conduct of this study, we also obtained expert advice and comment from Mr. Henry Saville, retired Partner with accountancy firm KPMG and a practicing Insolvency Practitioner until December 2003 (paragraphs 1.13 - 1.16).

The Insolvency Service's Change Management Programme

6. The Department told us that, since the beginning of 2000, there has been a 'step change' in the nature of the work required from the Insolvency Service examiners. Although 'new' insolvency legislation had been introduced in 1991, there were still a large number of legacy cases which continued to be handled through the 1990s, under the previous legislation. By 2000, the number of these cases had declined considerably and the emphasis in the work required from examiners switched from administration and realisation to investigation. This required a significant change in the Insolvency Service's working practices and culture.

7. After a period of time, it became apparent that some long-serving examiners were experiencing difficulties with the required changes and so, during the period from April to November 2001, the Insolvency Service facilitated the transfer of four examiners (out of a total complement of eight) to other branches in the Department. The Department said that, inevitably, this resulted in a temporary dip in the performance of the Service, arising from the loss in experience as new staff had to be recruited and trained. It also said that, in addition to the changes in personnel, a number of other initiatives were introduced in the Service between early 2000 and mid-2001. These included additional training, as well as changes to policies, processes/procedures and information sharing.

8. The Department also commented that, since the date of NIAO's main fieldwork, the Insolvency Service had embarked on a four-year change management programme. Current processes have been benchmarked against the equivalent processes in the Insolvency Service (England and Wales) and the European Foundation for Quality Management Model is being used to identify further areas for improvement. The programme is an integral part of the Department's e-Business Strategy and will deliver improved and more integrated services to the Insolvency Service's customers (paragraphs 1.17 - 1.18).

Main Findings and Recommendations

On the Effectiveness of Assessing Directors' Conduct (Part 2)

9. Insolvency Practitioners and the Official Receiver are required to report to the Department on the conduct of current and previous directors of insolvent companies. Their submission is in the form of either a '**Report'** (of ***unfit*** conduct); or a '**Return'** (of ***no unfit*** conduct). Timeliness of submissions is a key aspect of the disqualification process. An application for disqualification of a director has to be made within two years of the insolvency. Key timescales within the submission process are:

- **six months** - practitioners are required to make a submission to the Insolvency Service on the directors' conduct within six months of the 'relevant date' of the insolvency (typically the date of the practitioner's appointment). This submission can, however, take the form of an interim or holding submission, where the practitioner has insufficient evidence to make a final Report or Return and requires more time to form an opinion. Guidance states that only in 'exceptional circumstances' should the final submission require a time extension beyond the initial six-month period
- **nine months** – if there has been an interim submission at six months, it has become 'custom and practice' for the Insolvency Service to provide a three-month time extension for the receipt of the final submission (paragraphs 2.1 - 2.3).

Timeliness of Submissions

10. We reviewed 774 cases covering the period from October 1991 to September 2002, a half of all cases submitted. Overall, 40 per cent of final submissions by practitioners were outside the six-month timescale, with some ten per cent of final submissions still outstanding by the nine-month target outlined in the guidance. Of these, a further five per cent were received within the following four weeks. Overall, the performance of the Official Receiver was better than the Insolvency Practitioners. As regards 'Reports' of unfit conduct, Official Receiver staff were twice as likely as their private sector counterparts to submit their Reports within the initial six-month deadline (with respective submission rates of 52 per cent and 27 per cent) (paragraphs 2.4 - 2.11).

11. We consider that there is scope for the Insolvency Service to seek to improve the performance of practitioners (both Official Receiver staff and Insolvency Practitioners). In our view, it should actively monitor and report to senior management on the numbers of submissions not filed on time so that it can better manage such cases. It should more rigidly enforce its target of receiving all final submissions by nine months and progressively introduce targets aimed at receiving the vast majority of final submissions by six months (paragraph 2.12).

12. In response, Insolvency Service said it has notified Insolvency Practitioners that, from July 2004, extensions beyond six months for the submission of Reports or Returns would be allowed only in exceptional circumstances. In addition, a reminder letter will be issued to Insolvency Practitioners with a submission outstanding at five months. Where the six-month deadline is missed, the case will be followed-up with the particular Insolvency Practitioner and their 'Recognised Professional Body' will be informed. The Service said these actions have resulted in a significant improvement in the submission of Reports and Returns from Insolvency Practitioners (paragraphs 2.13 - 2.14).

The Monitoring and Compliance Framework

- Insolvency Practitioners

13. In the private sector, individuals are authorised to act as Insolvency Practitioners either directly by the Department, or by one of seven 'Recognised Professional Bodies' (RPBs). RPBs are required to ensure that the individuals are 'fit and proper' to work as Practitioners and to assure their education, practical training and experience. If Insolvency Practitioners are appointed directly by the Department, the Insolvency Service's 'Insolvency Practitioner Compliance Unit' is responsible for their monitoring.

14. The Insolvency Service has established a minimum standard – 'Principles for Monitoring Insolvency Practitioners' - which it and the RPBs must apply to their respective Practitioners. This requires an objective assessment of Insolvency Practitioners through desktop monitoring, together with visits to ensure they have complied with all aspects of insolvency law and practice. When the Insolvency Service inspects each RPB (on a three-year inspection cycle) part of the assessment involves a joint-monitoring visit to an Insolvency Practitioner, undertaken by an RPB official and an Insolvency Service inspector. These visits have generally found weaknesses in the systems and procedures used (paragraphs 2.38 – 2.40).

15. In our opinion, there is a weakness in the monitoring framework. Visits are not intended to assess whether the Insolvency Practitioner's opinion (on whether or not there has been unfit conduct) is soundly-based. In our view, this should be a fundamental requirement. Without such assurance, the Insolvency Service has no means of satisfying itself that Insolvency Practitioners are interpreting and applying the legislation consistently and fairly. We consider that the Service could strengthen its monitoring of Insolvency Practitioners if it:

- **revised and strengthened the current minimum standard, so that it allowed the Insolvency Service and RPBs to review the information underpinning an Insolvency Practitioner's opinion on directors' conduct and ensure the opinion was consistent with the evidence held**
- **put mechanisms in place to allow the Insolvency Practitioner Compliance Unit to undertake spot-checks of any Insolvency Practitioner (paragraphs 2.41 – 2.42).**

16. The Insolvency Service told us that the minimum standard document, which governs the inspections, is applied throughout the United Kingdom and any alterations to it would require the agreement of RPBs and the Insolvency Service in Great Britain through the Joint Insolvency Committee.

17. We recommend, therefore, that the Insolvency Service raises this issue with its GB counterpart with a view to discussing possible changes with RPBs. An assessment of the evidence available, to check that it supports the reasonableness of the decisions made, is a common feature of quality control reviews (paragraph 2.43).

- Official Receiver Unit

18. The Official Receiver unit is not subject to the same monitoring and compliance framework as Insolvency Practitioners. The first review of the unit was undertaken in August 2001. This was an internal review, by the Insolvency Practitioner Compliance Unit (IPCU) and covered issues such as the quality of administration and investigations and the reporting of unfit conduct. The Department told us that the review was commissioned by the Director of Insolvency as part of an improvement process which began in 2000. The purpose and rationale of the review was to stimulate a programme of change by drawing specific attention to, and highlighting, deficiencies in the administrative handling of a selection of cases and to use the findings as broader learning and development opportunities for staff, leading to improved awareness and performance. The review noted a number of deficiencies in the Official Receiver's work, including:

- there was little evidence of a clear plan for the Official Receiver's investigation and/or there had been a lack of a proper investigation undertaken - the review identified cases where there had been no attempt to chase up unanswered correspondence; and cases where there was no evidence on file of any investigation taking place. The Insolvency Service told us that it had recognised that, despite training being provided and guidance being available, not all examiners were carrying out investigations to the appropriate standard and that standardisation of the investigation and reporting processes was necessary. As a result, prior to the commencement of the IPCU internal review, it had introduced a 'pro forma' investigation plan, in March 2001, to supplement the Return or Report being submitted to IPCU. It said that the IPCU review covered cases that had commenced prior to the introduction of the pro forma
- cases were identified where 'Returns' of no unfit conduct were inappropriate and a 'Report' of unfit conduct did not disclose all the issues of unfit conduct apparent from the file
- the Directors' Disqualification Unit's requests and follow-up reminders for information went unanswered or unacknowledged for long periods of time and there were long periods of inactivity in the case-handling
- holding returns at six months had been used by staff in the Official Receiver unit simply because they had not at that stage undertaken any investigation.

The review's recommendations were accepted in full. We note that, through a process of individual and group meetings with staff, the Official Receiver and the Director of Insolvency have initiated a process to address all the issues raised (paragraphs 2.44 – 2.48).

19. The Department told us that a three-yearly review of the Official Receiver Unit is now Insolvency Service policy. In order to make the review process fully independent, we recommend that Insolvency Service consider whether future reviews could be undertaken by external assessors, such as the Great Britain Insolvency Service Inspectorate (paragraphs 2.50- 2.51).

On the Performance of Insolvency Service in Taking Unfit Conduct Cases (Part 3)

20. In the period from October 1991 to 31 March 2003, the Directors' Disqualification Unit (DDU) received a total of 1,521 submissions, some 37 per cent of which were 'Reports' of unfit conduct (the remainder being 'Returns' of no unfit conduct). Of the Reports, DDU took court proceedings in 157 cases, that is, approximately 10 per cent of all insolvency cases. The Department told us that, over a similar period, the Insolvency Service in GB initiated disqualification proceedings in 7 per cent of its insolvency cases (paragraph 3.2).

Procedures for Validating Directors' Conduct

21. Insolvency Practitioners are not required under the legislation to provide additional information – such as the company history, the nature and size of insolvency or the nature and extent of their findings on the directors' conduct – but are required to sign off on the Return that they are not aware of any matters requiring a report of unfit conduct. By contrast, the Official Receiver's Returns provide supplementary information including the size of deficiency, the reasons for insolvency and the extent of complaints from creditors (paragraphs 3.3 – 3.6).

22. For Insolvency Practitioners, DDU generally relies entirely on the Practitioner's opinion of no unfit conduct without any substantive information on the individual cases. The Department told us that the general approach is to rely on the professional opinion of Insolvency Practitioners. In our view, there would be greater assurance to DDU on Insolvency Practitioner cases if, as a standard procedure, a more comprehensive set of information was provided by Insolvency Practitioners in all cases (paragraph 3.10).

23. We recommend that the Insolvency Service reviews its information requirements from Insolvency Practitioners. This should not be an administrative burden on Practitioners, since the information should be available from the work already done, when they are forming their opinion on a case - for example, it could take a similar form to the supplementary information currently required from the Official Receiver when submitting a Return of no unfit conduct (paragraph 3.11).

24. The Department has said that there are difficulties with this recommendation, not least the current legislative position that only requires Insolvency Practitioners to complete a standard form of 'Return' or 'Report'. The Insolvency Service believes that this recommendation will be fiercely resisted by the profession, or only accepted if Insolvency Practitioners are paid for the additional work. It said that, where an insolvent estate has funds, the Insolvency Practitioner will take his payment from these funds, at the expense of creditors, and where the estate has insufficient funds then payment will be sought from Insolvency Service which in practice will mean the public purse. In our view, this is a matter worth pursuing and we suggest that the Insolvency Service explores the issue with the Insolvency Service in Great Britain and with the RPBs. We note that, in our own dealings with Insolvency Practitioners, both during interviews and in response to our survey questionnaire, they were keen to engage with the Insolvency Service to ensure that unfit directors are disqualified (paragraphs 3.12 - 3.13).

Appraising Reports of Unfit Conduct – Target Deadlines

25. We found that in a significant proportion of cases, Insolvency Service had not managed

to meet its internal administrative deadlines or its corporate target of submitting all affidavits to the Departmental Solicitor within 21 months. Failing to meet interim deadlines puts pressure on the disqualification process and creates the risk that appropriate cases for disqualification are not progressed within the two-year time limit. Our review of a sample of 35 cases noted three instances where the cases appeared to be overlooked, investigations were not completed or inadequate time was left to clear points raised by the Departmental Solicitor, with the consequence that disqualification was not pursued. The internal review of the Official Receiver (paragraph 18 above) identified many instances where staff failed to respond to DDU queries (paragraphs 3.21 - 3.26).

26. In our view, it is essential that the Directors' Disqualification Unit and the Official Receiver communicate effectively and maintain a good working relationship. Insolvency Service needs to ensure that deadlines for submissions of Reports and Returns are rigidly adhered to and it must establish and enforce administrative deadlines so that queries are dealt with in a timely manner (paragraph 3.27).

27. The Department said that Insolvency Service is strengthening DDU with appropriate staffing and other resources, including information technology. In addition, the Official Receiver and DDU are now monitoring the timeliness of replies to enquiries, by meeting on a regular basis (paragraph 3.28).

On Engagement with External Stakeholders (Part 4)

28. Over the period 1991 to 2005, the average net deficiency per company insolvency in Northern Ireland was approximately £185,000. The Crown (HM Revenue and Customs) and business suppliers are the creditors most likely to lose money. Our survey of company directors illustrated the impact on the wider business community – 54 per cent of directors reported their companies had experienced losses as a result of other companies' insolvencies and many indicated that the losses had had a significant impact on their companies. Efficient and effective implementation of directors' disqualification legislation can act as an important deterrent in preventing unfit conduct by company directors (paragraphs 4.1 – 4.2).

Company Directors

29. We commissioned a survey of 200 company directors in Northern Ireland. Overall, our survey found that a majority of directors felt well informed about the responsibilities of directors and the factors that could lead to their disqualification under the Companies Order. However:

- as regards their duties and responsibilities under the legislation, 10 per cent indicated that they were not informed at all and a further 31 per cent that they felt not very well informed

- we asked whether directors recalled being given any formal – written or printed – information about the circumstances in which a company director can be disqualified and the procedures for enforcing such disqualification. Some 69 per cent of respondents indicated they were not informed at all. Only 7 per cent of those surveyed indicated that they had been given formal information from Government Departments

- the survey results also indicate that a significant proportion of directors are not familiar with issues such as to whom disqualification applies and what it actually means in practice
    - 70 per cent did not recognise that disqualification actually applies to all those directors who were, or should have been aware of the misconduct
    - approximately 30 per cent did not recognise that the director is disqualified from acting as a director of *any* company

- 85 per cent were not aware of the penalties for continuing to act as a director while disqualified (paragraphs 4.3 – 4.15).

30. We believe that there is scope for the Insolvency Service to improve its communication with company directors and to disseminate key information more effectively. This could in part be achieved through the wider agencies of the Department, such as Companies Registry and Invest Northern Ireland, which deal directly with the business sector and individual directors, and the Service should consider drawing up a joint action plan with the other parts of the Department. The Insolvency Service should also consider using electronic means, such as putting the register of disqualified directors and other information on the Department's web site (paragraph 4.16).

31. Insolvency Service told us that guidance leaflets for company directors would be put on the Companies Registry website from the start of 2005 and that a register of disqualified directors will become available at the end of 2005. Companies Registry is considering other initiatives to improve communication with company directors (paragraph 4.17).

Insolvency Practitioners

32. We surveyed the 48 Insolvency Practitioners based in Northern Ireland, receiving replies from 23. Our survey findings suggest that there is scope for the Insolvency Service to improve its communication during and after the processing of individual cases. Where DDU decides to actively investigate directors' conduct, all the Insolvency Practitioners surveyed indicated that they would welcome direct contact with DDU to discuss each case and to contribute to the scoping and methodology of the investigation. In addition, they told us that they would be interested in establishing regular meetings and/or workshops between themselves (as a group) and the Insolvency Service to receive briefings from the Insolvency Service on any new policies and procedures; clarify guidelines and standards for insolvency work; and to discuss any operational difficulties (paragraphs 4.18 – 4.21).

33. We recommend that the Insolvency Service responds to the findings from our consultations with Insolvency Practitioners. It should build on its existing arrangements for the dissemination of advice and guidance on insolvency matters and meet with practitioners on a regular cycle to develop common understanding and expectations on all aspects of insolvency work and to clear any operational difficulties. This will contribute to the professional development of both the Insolvency Service and Insolvency Practitioners and should enhance working relationships. DDU should also seek to ensure that it deals with cases in a timely manner, as requested by Insolvency Practitioners, and consider liaising more pro-actively with them on individual cases (paragraph 4.22).

34. The Department said that the Insolvency Service met with the RPBs in December 2004 to take their views on the frequency and areas for discussion in future meetings with the Insolvency Practitioners. Following the meeting with RPBs, the Insolvency Service held a number of Workshops for Insolvency Practitioners in March 2005 and these will now be held on an annual basis (paragraph 4.23).

- Perceptions on the Insolvency Service's Implementation of the Legislation

35. In our survey, we asked the Insolvency Practitioners how successful they felt the Insolvency Service's implementation of the legislation had been in meeting each of its objectives. The majority of respondents (around two-thirds) considered that the Insolvency Service had been quite successful in its implementation, although a substantial minority (about one third) considered it had not been very successful. While 30 per cent considered the Service was bringing proceedings against a sufficient number of unfit directors, 30 per cent considered it was not and, although 42 per cent considered the Service acted

quickly enough to protect the public interest and creditors, 26 per cent felt it did not act fast enough.

36. In our view, these findings merit consideration and we recommend that the Service consults with Insolvency Practitioners in a more structured and systematic fashion, formally reviews the feedback from this consultation and uses the results to determine whether or not it can improve the effectiveness of the implementation of the disqualification legislation. This should be done with the involvement of the Recognised Professional Bodies (paragraphs 4.24-4.28).

37. As noted above (paragraph 34), the Insolvency Service met with the RPBs (December 2004) and Insolvency Practitioners (March 2005).

Part 1

Introduction and Background

1.1 At March 2005, there were some 30,000 companies registered in Northern Ireland and approximately 155,000 directorships within those companies. The majority of registered companies in Northern Ireland (over 99 per cent) have limited liability status. The shareholders of limited liability companies are not personally liable for debts should their company subsequently fail, unless they have given a personal guarantee or contravened certain provisions of company law.

1.2 Around 135 companies become insolvent (where a company's debt and liabilities exceed its assets) each year. The legislation (currently the Company Directors' Disqualification (Northern Ireland) Order 2002), provides for directors of such insolvent companies to be disqualified if there has been 'unfit conduct' by them. Disqualification can be for between two and 15 years. The aim of the legislation is to deter abuse of limited liability status (because many directors are also shareholders of their companies) and to protect future creditors from the actions of unfit directors. The Department has pointed out that the legislation cannot, and does not, in itself, attempt to prevent insolvencies. Over the period from October 1991 (the establishment of the Insolvency Service) to March 2005, there were some 1,790 company insolvencies in Northern Ireland. The combined net losses to creditors over this period were approximately £330 million in total, or some £24 million per year.

1.3 Unfit conduct by directors includes negligence, incompetence or lack of commercial integrity (**Appendix 1**). Specific examples of unfit conduct (see the example of the successful disqualification at **Case Study Illustration A**) include:

- causing the company to continue to trade knowing that it is insolvent
- failing to keep proper accounting records
- failing to prepare and file accounts or make returns to the Registrar of Companies

Case Study Illustration A

Estimated deficiency to creditors: £1,242,000

A director of a software and computer services company was disqualified for 9 years in 2001-2002. The unfit conduct included:

- trading with the knowledge that the company was insolvent
- retaining VAT, PAYE income tax and National Insurance Contributions
- failing to ensure that the company's accounts were prepared and filed
- failing to maintain/preserve statutory records (for example, minutes of the company Board meetings, register of shareholders)
- failing to co-operate with the Official Receiver (appointed by the Courts in compulsory insolvencies such as this)
- failing to account for the company's estimated deficiency of £1,242,000.

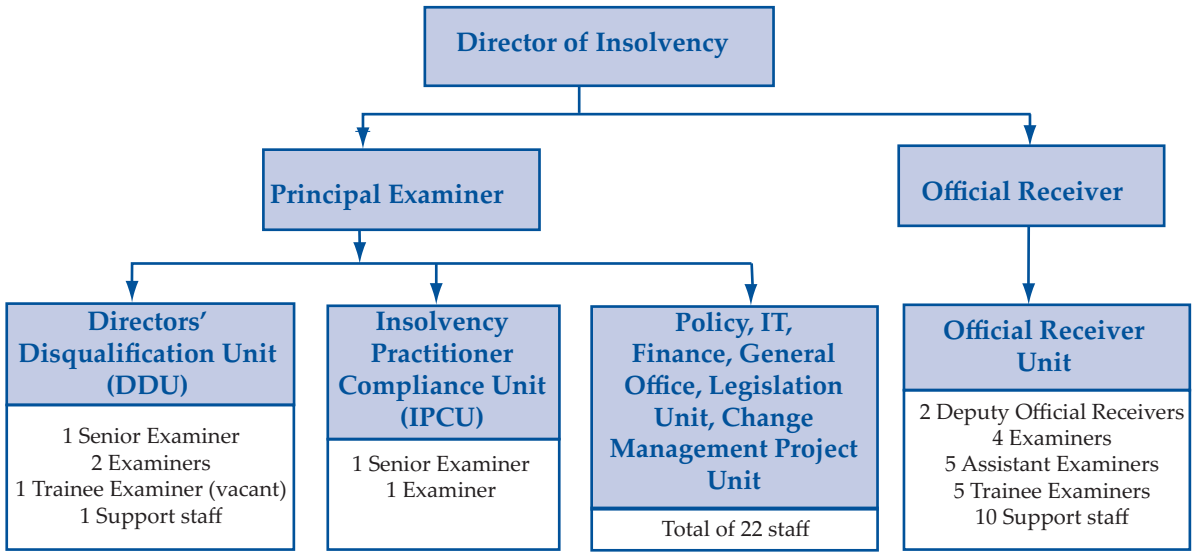
The judge commented that *".. it is hard to see … how a limited company could have been run in a more cavalier way".*

- failing to submit returns or pay over to the Crown any tax or national insurance due so as to finance insolvent trading.

The Insolvency Service

1.4 The Insolvency Service (**Figure 1**) is an operational unit within the Department and is the main body responsible for administering the legislation on directors' disqualification. The Insolvency Service is tasked with promoting and maintaining the integrity and working of the market place by:

Figure 1: The Insolvency Service - Organisation and Management Structure (March 2004)



Source: Insolvency Service

- administering and investigating the affairs of bankrupts and companies in compulsory liquidation; and
- handling the disqualification of directors in all company insolvencies.

By disqualifying unfit directors, the Insolvency Service reduces the likelihood of future insolvencies which may be caused as a result of misconduct by directors of a previously failed company.

The Official Receiver and Insolvency Practitioners

1.5 The identification and reporting of directors' unfit conduct is undertaken by the Official Receiver (OR) or by private sector Insolvency Practitioners. The OR is a civil servant within the Insolvency Service and an officer of the High Court. He is responsible for administering and investigating all compulsory liquidations (where companies are wound-up by the courts). He and his staff must investigate the conduct of directors involved in compulsory liquidations and provide a report on their findings.

1.6 Insolvency Practitioners, generally qualified accountants or solicitors, are appointed to act in voluntary liquidations, administrations and receiverships (where companies are wound-up by shareholders or creditors) and are required to report to the Insolvency Service on any suspected unfit conduct by directors which they become aware of in the normal course of administering the insolvency.

1.7 Both the OR and Insolvency Practitioners submit their reports to the Insolvency Service's Directors' Disqualification Unit, where a final decision is made whether or not to initiate disqualification proceedings (**Figure 2**).

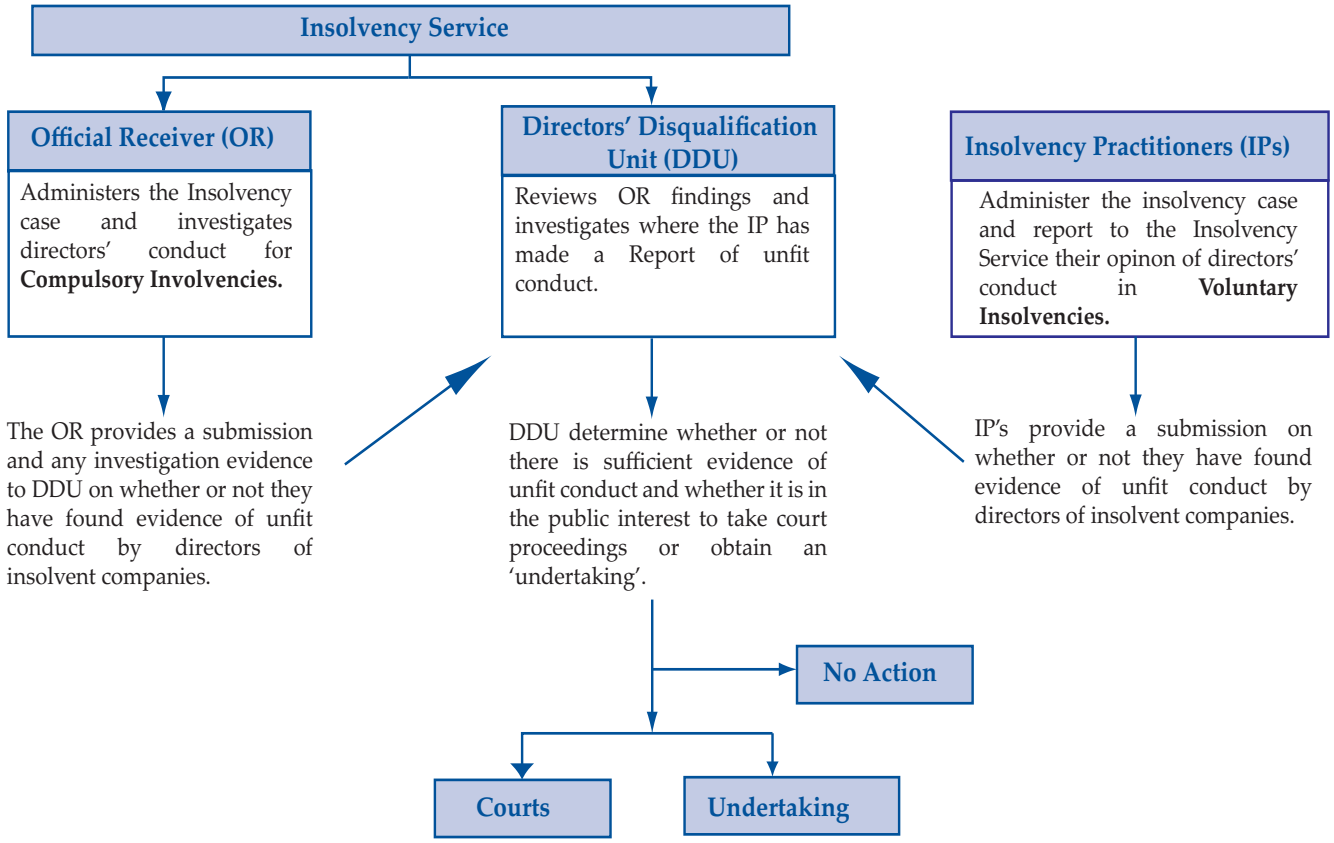
The Insolvency Service's performance in disqualifying directors

1.8 Since its establishment in October 1991, the Insolvency Service has initiated 157 applications for disqualification, up to 31st March 2005, with each application covering at least one director. This has resulted in:

- 118 disqualification orders from the courts covering 209 directors

1 In addition to the High Court's power to disqualify directors, the Department has been able (from September 2003) to accept, in the case of a director who it considers to be unfit and who consents to give it, a legally binding undertaking not to act as a director. This has the same effect as a Court Order.

Figure 2: The disqualification process – key roles and responsibilities



Source: Insolvency Service

- 22 applications for undertakings from 33 directors not to act as directors, being accepted by the Department and ratified by the Courts[1]
- 9 applications being closed without disqualification orders or undertakings[2]
- 8 applications before the Court, not yet completed.

1.9 The Insolvency Service has a statutory deadline which requires disqualification proceedings to be issued within two years of a company's insolvency. To support the achievement of this deadline, and as part of its wider corporate planning, the Insolvency Service sets two interim management targets for its disqualification activities. However, it has generally fallen short of these targets (**Figure 3**), therefore raising concerns about the timeliness and administration of disqualification cases.

1.10 The Department commented that, in its view, the correct context for assessing the Service's performance against targets for disqualification activities is achievement of the two-year statutory deadline for disqualification proceedings. It said that disqualification proceedings had been issued within the two-year deadline on all but one occasion (where the deadline had been inadvertently missed[3]). We would question the appropriateness

2 Three applications were withdrawn by the Department following submission of further evidence by the directors; two applications could not be 'served' on the directors (home addresses not known) and four applications were withdrawn as a result of police investigations.

3 In a case where DDU had proposed to take disqualification proceedings, it was realised by the Departmental Solicitor when considering the draft affidavit that the two-year statutory deadline had been missed – DDU had been working to the wrong relevant date. No further action was taken against the directors.

Figure 3: The Insolvency Service's performance against its published targets for disqualification activities

Key Target		96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05
To submit disqualification cases to the Departmental Solicitor for prospective proceedings within 21 months of the relevant date (i.e the date of the insolvency)	Target	95%	95%	95%	95%	100%	100%	100%	100%	100%
	Actual	95%	81%	67%	63%	8%	0%	25%	25%	63%
Official Receiver to submit disqualification returns to the Directors Disqualification Unit within 6 months of the relevant date	Target	95%	100%	100%	100%	100%	100%	100%	100%	100%
	Actual	95%	95%	88%	100%	93%	96%	96%	79%	93%

Source: Insolvency Service

of this as a performance measure. Because it includes only those cases where a decision has been made to go forward to proceedings, it is in effect self-fulfilling. It does not include those cases where proceedings might have been taken but were not progressed because it was clear that the Insolvency Service's investigations or affidavits would not be completed on time (see also paragraph 3.22). The Department has accepted this point.

Reviews of Directors' Disqualification in Great Britain

1.11 In Great Britain (GB), the Westminster Public Accounts Committee (PAC) reported on the effectiveness with which the Insolvency Service in GB undertook company director disqualifications. Its report identified a number of concerns including:

- the Insolvency Service was not pursuing as many cases as it should against unfit directors
- there was a significant amount of wasted effort caused by the high rejection rate of poor quality cases from the practitioners
- there were inadequate arrangements to ensure that disqualification orders were being applied
- there was a lack of awareness among company directors of the relevant disqualification legislation.

1.12 The National Audit Office produced a follow-up report on company director disqualification in 1999[4]. This report noted that the Insolvency Service in GB had made significant improvements and addressed the concerns previously identified. They had increased levels of disqualification and detailed research pointed towards substantial savings to creditors who would otherwise have suffered financial loss from insolvencies caused by directors of failed companies going back into business.

4 NAO 'Company Director Disqualification – A Follow Up report', HC 424, 14th May 1999

Scope of the NIAO Study

1.13 NIAO decided to examine the Insolvency Service's arrangements for disqualifying company directors in Northern Ireland for a number of reasons. These included the importance of director disqualification in promoting the integrity and working of the market place; the evidence from the Insolvency Service's published performance indicators that it has failed to meet its internal management targets in this area; and the concerns raised by the Westminster PAC about these issues in Great Britain.

1.14 The scope of NIAO's examination covered:

- the effectiveness of the Official Receiver and of Insolvency Practitioners in assessing directors' conduct (Part 2 of our Report)
- the performance of the Directors' Disqualification Unit in taking forward unfit conduct cases (Part 3)
- the extent to which the organisation is engaging with key stakeholders to improve the standards of company stewardship (Part 4).

1.15 During this study, NIAO:

- surveyed 200 registered company directors to measure their awareness of the disqualification legislation and of the Insolvency Service and their perceptions on the effectiveness with which the legislation was being enforced
- surveyed 48 Insolvency Practitioners and held structured interviews with 5 Insolvency Practitioners to gauge their views on the Insolvency Service and its implementation of the legislation
- reviewed a selection of the Insolvency Service's files to examine the quality and timeliness of their case administration. Cases selected covered the period to March 2003 to allow the two-year period to elapse in which disqualification proceedings could be initiated
- analysed the Insolvency Service's performance data on disqualification.

More details on the survey methodologies are presented in **Appendix 2**.

1.16 To assist in the conduct of this study, we also obtained expert advice and comment from Mr Henry Saville, retired Partner with accountancy firm KPMG and a practising Insolvency Practitioner until December 2003.

The Insolvency Service's Change Management Programme

1.17 The Department told us that, since the beginning of 2000, there has been a 'step change' in the nature of the work required from the Insolvency Service examiners. Although 'new' insolvency legislation had been introduced in 1991, there were still a large number of legacy cases which continued to be handled through the 1990s, under the previous legislation. By 2000, the number of these cases had declined considerably and the emphasis in the work required from examiners switched from administration and realisation to investigation. This required a significant change in the Insolvency Service's working practices and culture. After a period of time, it became apparent that some long-serving examiners were experiencing difficulties with the required changes and so, during the period from April to November 2001, the Insolvency Service facilitated the transfer of four examiners (out of a total complement of eight) to other branches in the Department. The Department said that, inevitably, this resulted in a temporary dip in the performance of the Service, arising from the loss in experience as new staff had to be recruited and trained. It also said that, in addition to the changes in personnel, a number of other initiatives were introduced in the Service between early 2000 and mid-2001. These included additional training, as well as changes to policies, processes/procedures and information sharing.

1.18 The Department also commented that, since the date of NIAO's main fieldwork, the Insolvency Service had embarked on a four-year change management programme. Current processes have been benchmarked against the equivalent processes in the Insolvency Service (England and Wales) and the European Foundation for Quality Management Model is being used to identify further areas for improvement. The programme is an integral part of the Department's e-Business Strategy and will deliver improved and more integrated services to the Insolvency Service's customers.

1.19 We consider that this report can make an important contribution to the change management programme in the area of director disqualification.

Part 2

Assessing Directors' Conduct

Background

2.1 Insolvency Practitioners and the Official Receiver (jointly referred to as 'practitioners') are required by the legislation to report to the Department on the conduct of current and previous directors of insolvent companies. Their submission to the Department is in the form of either a **Report** (of ***unfit*** conduct); or a **Return** (of ***no unfit*** conduct).

2.2 The effectiveness with which Insolvency Practitioners and the Official Receiver discharge this duty can be gauged by a number of factors. These include the following:

- **timeliness of submissions** – timeliness is a key aspect of the disqualification process. An application for disqualification (supported by an affidavit) of a director has to be made no later than two years from the date of the insolvency. Consequently, the time taken by practitioners to make their submissions to the Directors' Disqualification Unit of the Insolvency Service affects its overall administration and ability to initiate proceedings under the legislation (see paragraphs 2.3 - 2.17)
- **consistency of submissions** – the disqualification legislation is not entirely prescriptive and requires subjective judgement by practitioners. It is therefore important that submissions are consistent in nature, so that the conduct of individual directors is assessed in a fair and equitable manner (see paragraphs 2.18 - 2.26)
- **monitoring and control framework** – it is important that the Insolvency Service has in place a structured and robust framework so that the submissions both from the Official Receiver and from Insolvency Practitioners are appropriately monitored and controlled (see paragraphs 2.27 - 2.51).

The Timeliness of Submissions

2.3 There are a number of key timescales within the submission process which impinge upon the overall two-year deadline for applications for disqualifications and against which the performance of the Insolvency Service in managing practitioners' work can be assessed. These are:

- **six months** - practitioners are required to make a submission to the Insolvency Service on the directors' conduct within six months of the 'relevant date' of the insolvency (typically the date of the practitioner's appointment). This submission can, however, take the form of an interim or holding submission, where the practitioner has insufficient evidence to make a final Report or Return and requires more time to form an opinion. It should be noted, however, that the Insolvency Service's training guidance for Official Receiver examiners states that in only a small minority of cases, where there are 'exceptional circumstances', should the final submission require a time extension beyond the initial six month period
- **nine months** – if there has been an interim submission at six months, it has become 'custom and practice' for the Insolvency Service to provide a three-month time extension for the receipt of the final submission. The Insolvency Service has issued guidance to Insolvency Practitioners and to the Official Receiver which establishes a nine-month target for final submissions.

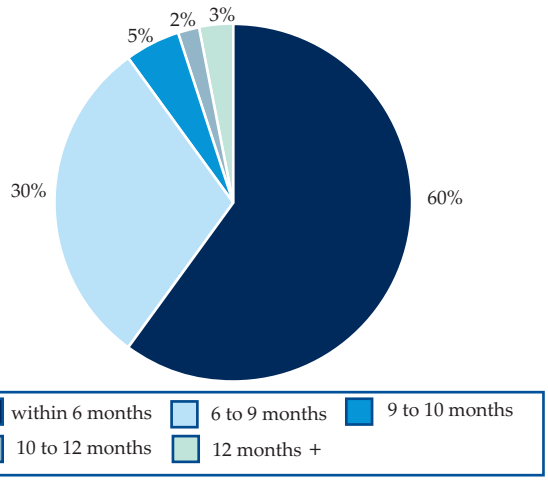
The Insolvency Service follows-up cases where target deadlines have been missed – following the six-month statutory deadline, a reminder is issued and, if a further reminder is required, this is copied to its Insolvency Practitioner Compliance Unit. Where the nine-month administrative deadline is missed, the Insolvency Service consults with the practitioner and negotiates a deadline for final submission of a Report or Return.

Overall Timeliness

2.4 To assess the timeliness of submissions, NIAO reviewed 774 cases covering the period from October 1991 to September 2002. This represented a half of all cases submitted to the Insolvency Service by Insolvency Practitioners or the Official Receiver over this period.

2.5 Overall, our review (**Figure 4**) indicated that a significant proportion (40 per cent) of final submissions by practitioners were outside the six-month timescale. Submissions over the following three months further reduced the proportion outstanding, although some ten per cent of final submissions remained outstanding by the nine-month target outlined in the guidance. Of these, a further five per cent were received within the four weeks following the nine-month deadline. The Insolvency Service told us that it manages and monitors all cases that have missed the nine-month deadline.

Figure 4: The timeliness of submissions by practitioners



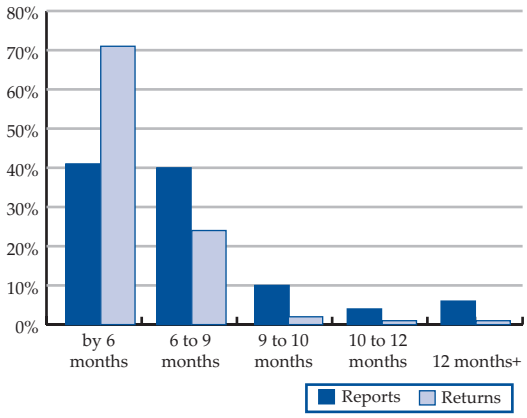
Source: Insolvency Service

The Timeliness of Reports of Unfit Conduct

2.6 Reports of unfit conduct are considered by the Insolvency Service's Directors' Disqualification Unit which then determines whether or not to proceed with a disqualification application. Because the application must be issued within two years of the relevant date, the timeliness of Reports is particularly important within the disqualification process.

2.7 Our analysis indicates that Reports of unfit conduct are made on a less timely basis than Returns of no unfit conduct (**Figure 5**). At the initial six-month deadline, less than a half (only 41 per cent) of all eventual Reports had been submitted, whereas almost three-quarters (72 per cent) of Returns had been submitted. By the nine-month target period, 81 per cent of Reports had been submitted, compared with 96 per cent of Returns. Some 5 per cent of Reports had still not been submitted after 12 months.

Figure 5: The relative timeliness of Reports of unfit conduct and Returns of no unfit conduct



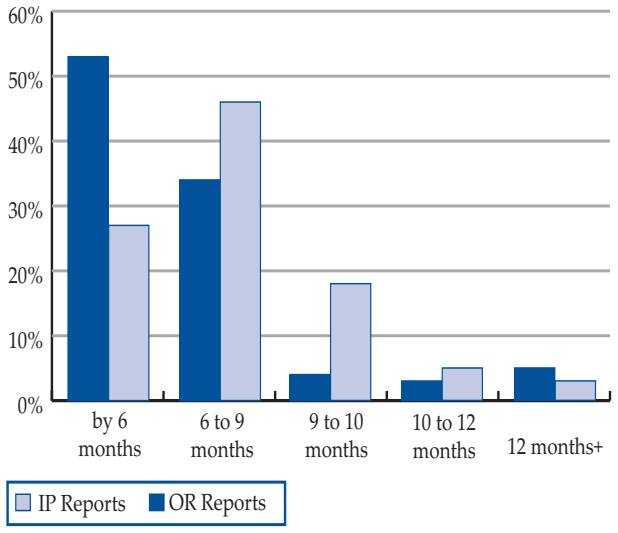
Source: Insolvency Service

The Relative Timeliness of Submissions by the Official Receiver and by Insolvency Practitioners

2.8 Overall, the performance of the Official Receiver was better than the Insolvency Practitioners in terms of the timeliness of their submissions. At six months the Official Receiver had submitted almost three-quarters (69 per cent) of his final submissions whereas the Insolvency Practitioners had submitted only a half (50 per cent) of theirs. The differences in performance became less marked by nine months, with both groups having made approximately 90 per cent of their final submissions.

2.9 Insolvency Practitioners are also less timely in submitting Reports of unfit conduct (**Figure 6**). Official Receiver staff were twice as likely as their private sector counterparts to submit Reports within the initial six-month deadline (with respective submission rates of 52 per cent and 27 per cent). It was a further two to three months before the Insolvency Practitioners achieved this level of submissions (52 per cent). Furthermore, a quarter (27 per cent) of Insolvency Practitioner Reports had still not been received after the nine-month target (compared with 19 per cent for Official Receiver staff).

Figure 6: The relative timeliness of OR and IP Reports of unfit conduct



Source: Insolvency Service

Comparison of Insolvency Practitioners in Northern Ireland with Great Britain

2.10 Our review also indicates (**Figure 7**) that the Insolvency Service in Northern Ireland has been less successful than its GB counterpart in obtaining timely submissions from Insolvency Practitioners. Relative to GB, Insolvency Practitioners in NI were less likely to submit Reports within the initial six-month deadline, although for the most recent year examined (2001-2002) in the NIAO fieldwork they did match the level of GB performance at nine months, by which time the overall levels of submissions were broadly comparable.

Figure 7: The Performance of Insolvency Practitioners in Northern Ireland and in Great Britain for companies becoming insolvent in 2001-2002.

Performance Measure	Insolvency Practitioners (NI)	Insolvency Practitioners (GB)
Reports submitted within 6 months	17%	57%
Reports submitted within 9 months	87%	85%
Reports still not submitted after 12 months	0%	2%

Source: Insolvency Service (NI); Insolvency Service (GB)

Scope for Improving the Timeliness of Final Submissions

2.11 Given the two-year statutory deadline for preparing the affidavit, the longer that practitioners take to make their final submissions, the shorter the period remaining and the greater the pressures on the Directors' Disqualification Unit, to satisfactorily complete its work on time. It is of some concern, therefore, that over the period 1991 to 2002 one in ten of all submissions were submitted after the nine-month target and approximately one in 20 Reports of unfit conduct from the Official Receiver and Insolvency Practitioners remained outstanding more than one year after the relevant date.

2.12 We consider that there is scope for the Insolvency Service to seek to improve the performance of practitioners in this matter. In our view, it should actively monitor and report to senior management on the numbers of submissions not filed on time so that it can better manage such cases. It should more rigidly enforce its target of receiving all final submissions by nine months and should progressively introduce targets aimed at receiving the vast majority of final submissions by six months, especially since the OR training manual notes that final submissions after six months should only occur 'in exceptional circumstances'.

2.13 In response to our recommendation, the Insolvency Service informed us that it had notified Insolvency Practitioners that, from July 2004, extensions beyond six months for the submission of Reports or Returns to DDU would be allowed only in exceptional circumstances. In addition, DDU will issue a reminder letter to any Insolvency Practitioner with a submission outstanding at five months and monitor progress. Where the six-month deadline is missed, it will follow-up with the particular individual and notify the Insolvency Practitioner Compliance Unit, which will, in turn, inform the appropriate Recognised Professional Body (RPB) (see paragraph 2.27) to take action.

2.14 The Insolvency Service has since informed us that these actions have resulted in a significant improvement in the submission of Reports and Returns from Insolvency Practitioners – in the period 1 July 2004 to 30 June 2005, 60% of reports were submitted within 6 months, with 96% being submitted within 9 months.

2.15 We note that Insolvency Practitioners are slower to submit Reports than the Official Receiver in NI and also compared with their counterparts in GB. While the Insolvency Service can sanction Insolvency Practitioners for poor performance (by reporting them to their RPB or, in exceptional circumstances, by instituting legal proceedings with a view to bringing the matter before a Magistrate's Court which has the power to levy a fine), it has limited its use of such sanctions, in cases of late submissions, to reporting them to their RPB.

2.16 In our view, there would be merit in the Insolvency Service conducting a detailed review of the reasons why Insolvency Practitioners under-perform. This could include:

- discussions with Insolvency Practitioners in NI and their professional bodies to review the current systems and procedures and to identify why they are failing to deliver their final submissions on a more timely basis
- liaison with the Insolvency Service in GB to determine why Insolvency Practitioners in GB are able to report on a more timely basis than in NI
- dissemination of new and/or restated guidance to Insolvency Practitioners
- regular and systematic monitoring of the timeliness of Insolvency Practitioners' submissions to ensure satisfactory progress is being made.

As a last resort, the Insolvency Service could be more stringent in applying its sanctions, in order to improve the timeliness of submissions from Insolvency Practitioners.

2.17 In response to our recommendations, Insolvency Service told us that:

- it would hold annual meetings with the RPBs (these commenced in December 2004)
- there has been a series of visits by the Insolvency Service (NI) to Insolvency Service (GB) to carry out benchmarking exercises, including the comparison of the timeliness of Insolvency Practitioners' submissions
- it is to review its guidance every six months (this commenced in December 2004) revising it as appropriate
- monitoring of Insolvency Practitioners' submissions is taking place under the new arrangements introduced from July 2004 (paragraph 2.13).

The Consistency of Submissions

2.18 Because of the manner in which the disqualification process operates there is, in our view, potential for inconsistency in its operation. In particular:

- the legislation provides indicative illustrations of unfit conduct (including the extent of a director's responsibility for the failure of a company to supply any goods and services which have been paid for, the failure of a company to keep accounting records and failure to co-operate with the liquidator). However, the legislation is not definitive about the nature or degree of unfit conduct and as a consequence there is inevitably a degree of subjectivity in the decisions of Insolvency

Practitioners and of Official Receiver staff. The Insolvency Service's guidance on how to determine whether or not there has been unfit conduct notes that practitioners should not take a pedantic view of isolated technical failures, but should form an overall view of the director's conduct

- there are different investigation and submission requirements for the Official Receiver and for Insolvency Practitioners:
  - The OR is statutorily required to carry out a specific investigation into the conduct of directors of insolvent companies and has to provide supplementary information to support an opinion of no unfit conduct and provide a detailed report thereon
  - Insolvency Practitioners, however, are under no statutory requirement to carry out an investigation. They are only required to list those matters of unfit conduct which they encounter during the normal course of their insolvency work. Where they consider that there is no unfit conduct, they merely confirm this, but need not provide any supplementary information to support this opinion.

The degree or level of investigation required, and consequently the basis for the opinion, therefore, differs depending on who deals with the insolvency.

Variances in the submissions of individual Practitioners

2.19 To check on the consistency of submissions by practitioners, NIAO undertook a detailed analysis of the submissions of four Official Receiver staff and four Insolvency Practitioners. Based on an initial review of the overall trends, we selected two OR staff and two Insolvency Practitioners who submitted a relatively high proportion of Reports of unfit conduct and two from each group who submitted a relatively low proportion of Reports.

2.20 This analysis shows a wide variation in the likelihood of individual practitioners submitting Reports relative to Returns. It also indicated that, for some practitioners, only a small proportion of their Reports of unfit conduct actually led to the taking of disqualification proceedings whereas, for others, the likelihood of a Report leading to successful disqualification proceedings was much greater.

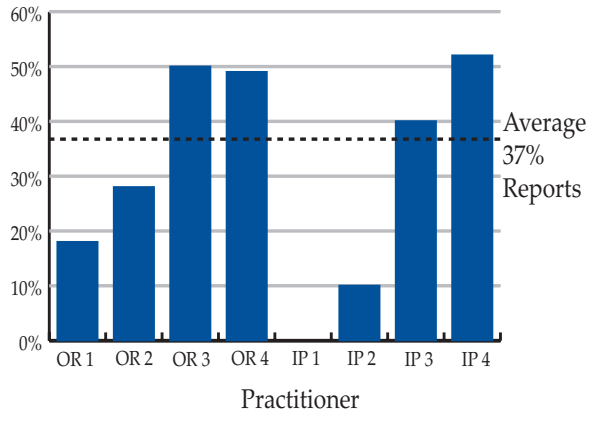
The likelihood of submitting Reports

2.21 Overall, the type of submissions from both Official Receiver staff and Insolvency Practitioners were broadly similar – approximately one third (37 per cent) were Reports (unfit conduct) and two-thirds (63 per cent) were Returns (no unfit conduct).

2.22 At a disaggregated level, however, our analysis showed considerable variations in the types of submission by individual practitioners with some submitting a small proportion of Reports and others a large proportion (**Figure 8**):

- one practitioner submitted no Reports and another submitted only one
- conversely, there were three of the eight practitioners for whom approximately half of their submissions were Reports.

Figure 8: The likelihood of individual practitioners submitting Reports

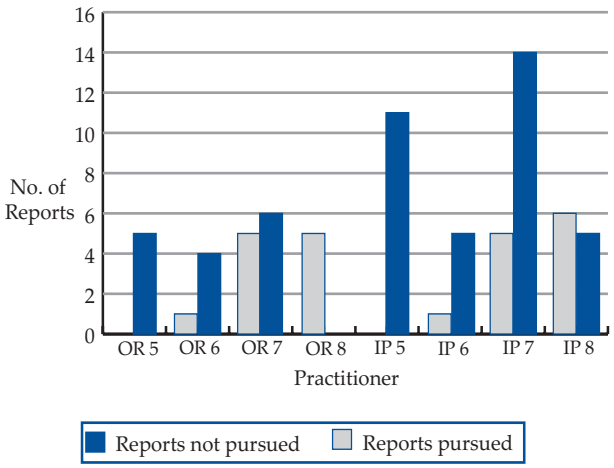


Source: Insolvency Service

The likelihood of a Report leading to disqualification proceedings

2.23 The Directors' Disqualification Unit does not take all Reports of unfit conduct to court proceedings - overall, approximately one-quarter (28 per cent) of Report cases will result in disqualification proceedings. Our analysis of eight individual practitioners (four Official Receiver staff and four Insolvency Practitioners), however, illustrates that there is a significant variance in the extent to which Reports of unfit conduct from individual practitioners result in disqualification proceedings (**Figure 9**). Two of the practitioners had none of their Reports pursued by the Directors' Disqualification Unit and another two had only one of their Reports pursued. Conversely, there was one practitioner for whom each Report of unfit conduct was proceeded with by the Directors' Disqualification Unit. The Insolvency Service commented that the Report itself is only the first of a number of factors to be taken into account when considering whether to take proceedings for disqualification. Other factors include: the likelihood of success of the proceedings; whether the director is already a bankrupt (bankrupts are disqualified from holding directorships) or being prosecuted for another offence (if found guilty, the judge can disqualify the individual) or is suffering from illness; precedents in similar cases; and the advice of the Departmental Solicitor.

Figure 9: The likelihood of a Report resulting in disqualification proceedings



Source: Insolvency Service

2.24 In our view, the existence of large variations in the likelihood of submitting a Report, ranging from 0 per cent to 52 per cent within our sample, (**Figure 8**) suggests that there may be inconsistent interpretation of the legislation by practitioners. In addition, there is potentially a wasteful use of the Insolvency Service's resources if it has to investigate a large number of Reports from individual practitioners but then determines that there is, in fact, insufficient evidence of unfit conduct in a substantial proportion of such cases (**Figure 9**).

2.25 Although we recognise that the Report is only one of a number of factors which the Insolvency Service takes into account when considering proceedings, we are concerned at the substantial numbers of Reports of unfit conduct which do not appear to merit proceedings by the Insolvency Service. We believe that there is scope for the Insolvency Service to enhance its monitoring of the work of practitioners and to assure itself that the variances between individual practitioners are not due to poor standards of work or inappropriate interpretation of the rules. At a general level, we consider it would be useful if the Insolvency Service could seek to ensure consistency of practitioners' opinions by:

- establishing management information systems to monitor patterns of submissions from individual practitioners
- using this information to identify practitioners with relatively high and/or low proportions of Returns and those for whom only a small proportion of Reports results in disqualification proceedings
- engaging in feedback with such practitioners to determine how they are interpreting unfit conduct
- using illustrative case studies from this process to develop its guidance and disseminate best practice (e.g. through a series of workshops with practitioners).

2.26 In response, the Insolvency Service has said that:

- the systems in place in DDU allows it to monitor whether reporting is in accordance

with its guidance and it will commence monitoring the pattern of reporting

- it will develop a greater level of engagement with Insolvency Practitioners, to include presentations and discussions
- it will develop its existing arrangements for updating Insolvency Practitioners by consulting annually with the RPBs to determine what further might be done to better inform them.

The Monitoring and Compliance Framework

2.27 To ensure that directors' conduct is being assessed effectively and consistently, it is important that the Insolvency Service has procedures in place to monitor the compliance of each of the parties involved in the submission of Reports and Returns to the Directors' Disqualification Unit – the Official Receiver and Insolvency Practitioners - and the Recognised Professional Bodies.

2.28 In the private sector, individuals are authorised to act as Insolvency Practitioners, either directly by the Department, or by one of seven recognised professional bodies (RPBs) (**Figure 10**). RPBs are required to ensure that the individuals are 'fit and proper' to work as Insolvency Practitioners and to assure their education, practical training and experience.

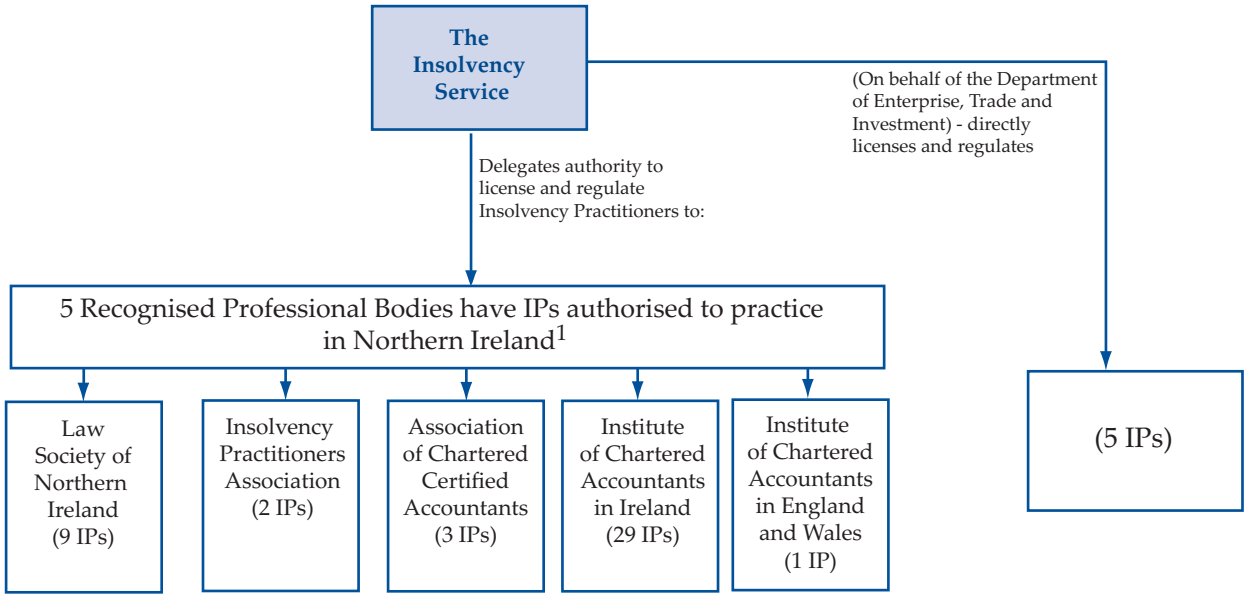
Monitoring of the Recognised Professional Bodies

2.29 The Insolvency Service has procedures in place to monitor the effectiveness of the seven RPBs to whom it has delegated authority to authorise and regulate the private sector Insolvency Practitioners. It has a Memorandum of Understanding with each RPB under which it is to receive an Annual Report of the RPB's monitoring and regulatory activities. It also has a target to inspect each RPB once every three years.

RPB Annual Reports

2.30 The annual reports required by the Insolvency Service from RPBs are an important means of monitoring their effectiveness. They should help the Insolvency Service to satisfy its wider public accountability responsibilities by providing assurances that RPBs are adequately authorising and regulating Insolvency Practitioners.

Figure 10: The appointment and regulation of Insolvency Practitioners (March 2004)



Source: Insolvency Service
Note: 1. Two Recognised Professional Bodies (the Law Society (England and Wales) and the Institute of Chartered Accountants in Scotland) did not have any IPs authorised to practice in Northern Ireland at March 2004.

2.31 To assess the effectiveness of this monitoring mechanism, we reviewed the 2001 and subsequent annual reports for each of the RPBs with Insolvency Practitioners in Northern Ireland. We found that the annual reports provided detailed narrative and analysis across a spectrum of information – licensing activity, monitoring visits, complaints and disciplinary outcomes – except for the 2001 report of the Law Society of Northern Ireland which provided only limited coverage of their activities (a statistical analysis of their authorisations of Insolvency Practitioners). This did not comply with the requirements of the Memorandum of Understanding, as it did not provide an analysis of insolvency complaints or disciplinary outcomes. There was no evidence that the Insolvency Service followed-up with the Law Society on the lack of information contained in its report. The Department told us that the Insolvency Service recognised the deficiencies in the Law Society's annual report and, as a result, a revised Memorandum of Understanding was drawn up. From 2002, the Law Society annual reports contain the same details as the reports of other RPBs.

Three-yearly inspections of RPBs

2.32 The Insolvency Service's inspections of RPBs are undertaken by its 'Insolvency Practitioner Compliance Unit' and aim to provide assurance on the competence of the bodies in regulating their Insolvency Practitioners. These inspections review the quality of the RPBs' administration, the appropriateness of their authorisation of Insolvency Practitioners, the quality of their complaints procedures and the standard of their monitoring of their Practitioners.

2.33 In our review of the inspections of RPBs, we noted that Insolvency Service worked closely with its GB counterpart in relation to monitoring visits (the RPBs are recognised by both NI and GB legislation). On occasions, they have formed joint monitoring teams, or one Service has relied on the other's inspection and report. However, in the case of the Law Society for Northern Ireland, all inspections are carried out by the local Insolvency Service.

2.34 Typically, the recommendations arising from inspections were aimed at enhancing RPBs systems and practices. However, we noted that the Unit's inspection of the Law Society in October 2000 found that there had been no formal written response to the recommendations in the previous inspection report (undertaken in 1996). Issues identified in the 1996 inspection remained evident, even though the Law Society had agreed to give careful attention to the inspection's recommendations for improvement. Further issues had also arisen. Matters raised included the lack of a regular programme for monitoring Insolvency Practitioners; failure of the Law Society to meet its monitoring obligations under the Minimum Standard (see paragraph 2.39); no provision for training Insolvency Practitioners or Law Society staff; Insolvency Practitioners' performance was not being fully considered when their licences were being renewed; and there was poor documentation and processing of complaints against Insolvency Practitioners.

2.35 Following the 2000 inspection report, the Law Society confirmed its acceptance of that report's recommendations and produced an action plan for implementation. The Insolvency Service conducted a series of follow-up visits to satisfy itself that the Law Society had undertaken the necessary changes.

2.36 While we welcome the manner in which the Law Society and the Insolvency Service responded to the 2000 report, we are concerned at the extent to which the failings in the original 1996 report were not promptly addressed and allowed to persist for so long. We recommend that the type of follow-up process adopted following the 2000 inspection of the Law Society should be formally adopted as part of the normal inspection procedures for all RPBs. A specific action plan should be drawn up, where necessary, after each inspection and the Insolvency Service should monitor the implementation of recommendations.

2.37 The Insolvency Service responded that it will carry out the follow-up process it used on the 2000 inspection of the Law Society in all cases where material issues are involved.

Monitoring of Insolvency Practitioners

2.38 If Insolvency Practitioners are appointed directly by the Department, the Insolvency Service's Insolvency Practitioner Compliance Unit is responsible for their compliance with the regulatory requirements. The respective RPBs monitor those Practitioners for whom they are responsible for authorising and regulating.

2.39 The Insolvency Service has established a minimum standard – 'Principles for Monitoring Insolvency Practitioners' - which it and the RPBs must apply. This requires an objective assessment of Practitioners through desktop monitoring, together with visits to ensure they have complied with all aspects of insolvency law and practice. The minimum standard provides a checklist and seeks primarily to ensure that the Insolvency Service's administrative guidelines (such as the timing of submissions on directors' conduct) are being adhered to.

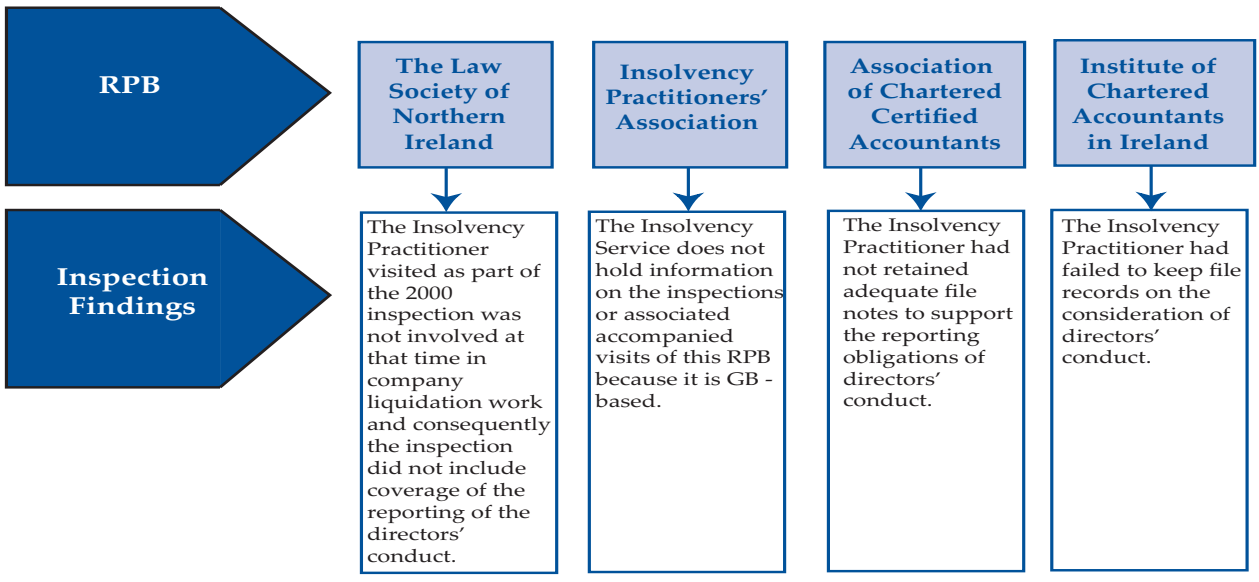
2.40 When the Insolvency Service inspects each RPB (three-year inspection cycle, see paragraph 2.29) part of the assessment involves a joint-monitoring visit to Practitioners, undertaken by an RPB official and an Insolvency Practitioner Compliance Unit inspector. Although there is only one joint visit per RPB inspection, these accompanied visits have generally found weaknesses in the individual Insolvency Practitioner's systems and procedures (**Figure 11**). The findings from the accompanied visits illustrate that there is scope to improve their discharge of disqualification duties.

2.41 In our opinion, another key weakness in the compliance monitoring framework is that monitoring visits are not intended to assess whether the Insolvency Practitioner's opinion (on whether or not there has been unfit conduct) is soundly-based. In our view, this should be a fundamental requirement of the Insolvency Service's monitoring and compliance framework for Insolvency Practitioners. Without such assurance, the Service has no means of satisfying itself that Insolvency Practitioners are interpreting and applying the legislation consistently and fairly.

2.42 We consider that the Insolvency Service could strengthen its monitoring of the compliance of individual Insolvency Practitioners if it:

- revised and strengthened the current minimum standard so that it allowed the

Figure 11: Accompanied visits to Insolvency Practitioners – inspection findings



Source: Insolvency Service

Insolvency Service and RPBs to review the information underpinning a Practitioner's opinion on directors' conduct for consistency with the evidence held

- put mechanisms in place to allow the Insolvency Practitioner Compliance Unit to undertake spot-checks of any Insolvency Practitioner to assess conformance with the minimum standard.

2.43 The Insolvency Service told us that the minimum standard document, which governs the inspections, is applied throughout the United Kingdom and any alterations to it would require the agreement of RPBs and the Insolvency Service in Great Britain through the Joint Insolvency Committee. We recommend, therefore, that the Insolvency Service raises this issue with its GB counterpart with a view to discussing possible changes, along the lines set out above, with RPBs. An assessment of the evidence available, to check that it supports the reasonableness of the decisions made, is a common feature of quality control reviews.

Monitoring of the Official Receiver Unit

2.44 The Official Receiver is a civil servant within the Insolvency Service appointed by the Department. He is also an officer of the High Court. The OR's principal functions relate to the administration of bankruptcies of individuals and compulsory company liquidations and he has a unit of 14 examiners (**Figure 1**) whose duties include assessing the conduct of directors of insolvent companies.

2.45 The Official Receiver unit is not subject to the same monitoring and compliance framework as Insolvency Practitioners and their RPBs. The Insolvency Service Operating Plans from 1998-1999 included a target to review the unit's casework by the year end. The first review of the unit was undertaken in August 2001 following a recommendation by the Department's Internal Audit Unit that an external peer review be established for the unit. The Department said that this was an internal review, undertaken by the Insolvency Service's Insolvency Practitioner Compliance Unit. It covered a range of issues such as the quality of administration and investigations and the reporting of unfit conduct.

2.46 The Department told us that the review was commissioned by the Director of Insolvency as part of an improvement process which began in 2000. The purpose and rationale of the review was to stimulate a programme of change by drawing specific attention to, and highlighting, deficiencies in the administrative handling of a selection of cases and to use the findings as broader learning and development opportunities for staff, leading to improved awareness and performance.

2.47 The review did not provide an overall opinion on the work of the OR unit as a whole. However, it reported a number of deficiencies in the unit's work in terms of the quality of investigations and the reporting of unfit conduct by directors. Findings included:

- there was little evidence of a clear plan for the Official Receiver's investigation and/or there had been a lack of a proper investigation undertaken (the review identified cases where there had been no attempt to chase up unanswered correspondence; and cases where there was no evidence on file of any investigation taking place) (**Case Study Illustration B**). The Insolvency Service told us that it had recognised that, despite training being provided and guidance being available, not all examiners were carrying out investigations to the appropriate standard and that standardisation of the investigation and reporting processes was necessary. As a result, prior to the commencement of the IPCU internal review, it had introduced a 'pro forma' investigation plan, in March 2001, to supplement the Return or Report being submitted to IPCU. It said that the IPCU review covered cases that had commenced prior to the introduction of the pro forma
- cases were identified where Returns of no unfit conduct were inappropriate and a Report of unfit conduct did not disclose all the issues of unfit conduct apparent from the file (**Case Study Illustration C**).

Case Study Illustration B

Estimated deficiency to creditors: £ 933,000

The IPCU's review of the case noted that the Official Receiver examiner's recommendation of *"no further investigation"* was made in November 2000, just over 4 weeks after the winding-up order. However, IPCU also noted that:

- the winding-up order was made in respect of a petition served by HM Customs and Excise claiming some £933,000
- in the case of one director of the company, there was a history of non-co-operation with the Insolvency Service in a previous insolvency.

The reviewers noted, in July 2001, that one formal case review had been undertaken on 22nd January 2001, but no further investigation had taken place (although they noted that the Official Receiver had offered guidance as to the level and nature of investigation to be undertaken).

IPCU considered this case was *"very suitable for the purposes of investigation"* and that, given the circumstances of this case, 4 weeks was an insufficient period in which to make a decision of no further action.

Case Study Illustration C

Estimated deficiency to creditors : £94,000

A Return of no unfit conduct was submitted to DDU on 3rd March 2001 indicating that the failure of the company was due to poor management.

DDU raised a number of queries with the OR examiner on 16th March 2001. After two reminders, the examiner responded on 8th May 2001 indicating that books and records were deficient (none for the final two years of trading) and that there were no company accounts for 1997-1998 and 1998-1999. DDU was asked to make a decision on whether or not proceedings were appropriate.

At this stage, DDU sought further details from the examiner on 18th May 2001. DDU got a response on 23rd July 2001, after its fourth reminder, in which the examiner now noted that there were in fact no records for the final 28 months of trading, there were Crown debts going as far back as the 1996-1997 tax year and that there was a list of dishonoured cheques (indicating the company traded with a knowledge it was insolvent) and these had been requested from the bank.

The IPCU review concluded *"…that inadequate investigation was undertaken in this case prior to the submission of a Return of no unfit conduct to DDU and that subsequent matters of possible unfit conduct have been identified only because of the persistence of DDU. It is unclear whether or not the [OR] examiner looked at the books and records of account prior to making the Return to DDU but the inadequacies in these records, together with the failure to prepare and file two sets of accounts and to note the period covered by the Crown claims should have been noted and reported by the examiner…".*

- the Directors' Disqualification Unit's requests and follow-up reminders for information went unanswered or unacknowledged for long periods of time and there were long periods of inactivity in the case-handling (**Case Study Illustration D**).

- holding returns at six months had been used by staff in the Official Receiver unit simply because they had not at that stage undertaken any investigation (**Case Study Illustration E**).

2.48 The Official Receiver informed us that he accepted the review's recommendations in full and that he and the Director of Insolvency have initiated a process to address all the issues raised by the review through individual and group meetings with staff. We welcome this response, but note that there was no formal response to the review, specifying the nature and timing of actions to be taken on foot of the recommendations. In our view, therefore, there is scope for the Insolvency Service to adopt a more structured and formal response to the review process.

Case Study Illustration D

Estimated deficiency to creditors: £500,000

The OR had asked at an early stage for the examiner to investigate a range of matters including creditor and customer complaints against the company; the possibility of a phoenix operation (directors making a company insolvent and then starting a new company without the liabilities of the old one); a reduction in the value of the company's fixed assets by £88,000 over 14 months; the circumstances giving rise to the creditor debts; diminutions in the value of stocks and debtors; and representations by the company to obtain supplies in the period prior to cessation of trading.

IPCU's findings included:

- there was no evidence to suggest that the matters raised by the OR were investigated prior to the submission of a Return of no unfit conduct to DDU on 17th October 2000
- between 18th October 2000 and 3rd May 2001 DDU had issued 8 requests for information before receiving a response that *"books and records still being investigated"*. DDU again raised the issue in a minute dated 23rd July 2001 and were still waiting a response by the date of the IPCU review (August 2001)
- there were long periods of inactivity in the case – including April 2000 to September 2000 when reminder letters were issued in respect of his initial case enquiries; September 2000 to February 2001 when the examiner dealt with a letter of enquiry; February 2001 to June 2001 when again the examiner dealt with a letter of enquiry; and June 2001 to 9th August 2001 when the examiner commenced his investigation into the phoenix allegation, enquired about Crown liabilities and issued a reminder letter
- *"... that there has been very little evidence of investigation in this case or of sustained effort to address the reasons for failure giving rise to an estimated deficiency at liquidation of almost £500,000."*

Case Study Illustration E

Estimated deficiency to creditors: £500,000

Based on its review of this case file, IPCU's opinion was that an interim return *"…has been used in this case, with an extension of time for submission of a final Return or Report, simply because no investigation has been undertaken at this point of time as opposed to because investigation is ongoing.*

There is no evidence of any investigation in this case with no attempt to contact Crown bodies to establish if they are creditors, no attempt to examine the debtor position with a view to collection of outstanding book debts, no investigation into the fixed asset position and no examination of accounts entries for the period to 31 December 1999 (the only accounts available)…".

2.49 We put it to the Insolvency Service that the Official Receiver unit should be subject to a three-year cycle of monitoring reviews. We also considered that:

- this should be formally established in the Insolvency Service plans and that the 'monitoring standard' appropriate for the Insolvency Practitioners should be applied to the Official Receiver unit

- the review process should conclude with the formal acceptance by the Official Receiver of the reviewers' report and an action plan for the implementation of the recommendations. This should be monitored to ensure appropriate and timely implementation.

2.50 In response, the Department told us that a three-yearly review of the Official Receiver Unit is now Insolvency Service policy. The Insolvency Service told us that the Monitoring Review of the Unit took place as planned in 2004-2005 and that a draft report had been forwarded to the Official Receiver for consideration and comment (an Action Plan has to be produced within 6 weeks of the inspection report). As regards the final bullet point above, we would re-iterate our view on the added value that external assessors would bring to future reviews of the Unit.

2.51 In order to make the review process fully independent, we also recommend that the Insolvency Service should consider whether future reviews could be undertaken by external assessors, such as the Great Britain Insolvency Service Inspectorate.

Part 3

The Performance of the Directors' Disqualification Unit in Taking Unfit Conduct Cases

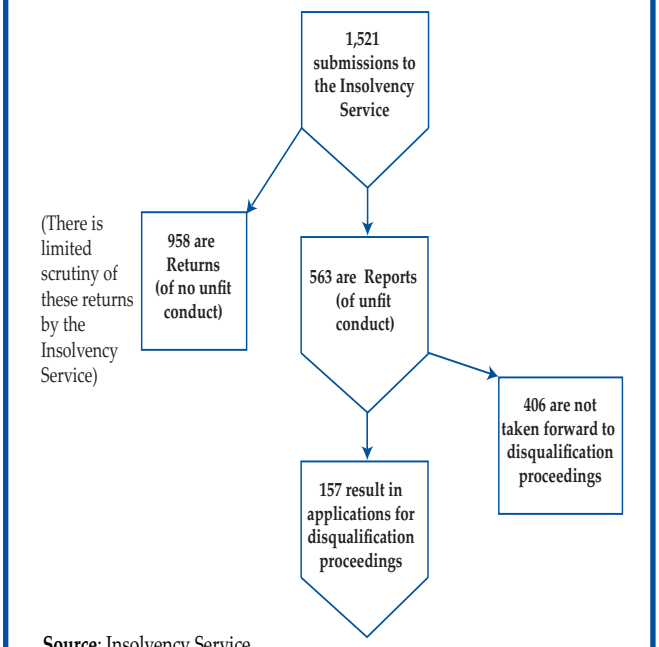
Background

3.1 It is important for the integrity of the market that the conduct of directors of insolvent companies is assessed and evaluated on a consistent basis. Within the Insolvency Service, the Directors' Disqualification Unit (DDU) plays a key role in the disqualification process. When an Insolvency Practitioner or the Official Receiver submits an opinion on a director's conduct, DDU appraises the case across a range of factors (see paragraph 2.18) and is ultimately responsible for determining whether or not it is in the public interest to take proceedings. Where proceedings are being taken, DDU must prepare an affidavit in Insolvency Practitioner cases or review the OR's affidavit so that a summons can be prepared and court action taken.

3.2 In the period from October 1991 to 31 March 2003, DDU received a total of 1,521 submissions, some 37 per cent of which were Reports of unfit conduct (the remainder being Returns of no unfit conduct). Of the Reports, DDU initiated disqualification proceedings in 157 cases, that is, approximately 10 per cent of all insolvency cases and 28 per cent of cases where the practitioners had submitted Reports of unfit conduct (**Figure 12**). The Department told us that, over a similar period, the Insolvency Service in GB initiated disqualification proceedings in 7 per cent of its insolvency cases and 21 per cent of cases with Reports of unfit conduct.

3.3 The initial submissions by the Official Receiver and Insolvency Practitioners play a key role in ensuring that the system operates efficiently and effectively. DDU has a system of basic checks for all submissions which it receives. It checks whether the company directors are currently on the register of disqualification orders or bankrupts and whether they have been involved in previous insolvencies. However, we consider it important that in reviewing these submissions, DDU:

Figure 12: The outcome of submissions to the Insolvency Service



Source: Insolvency Service

- has procedures to assure itself that Returns of no unfit conduct are soundly-based and can be supported by the evidence. If Returns are not soundly-based, there is a risk that directors who should be disqualified for unfit conduct will not be reported and will continue to have stewardship of companies
- makes sure that Reports of unfit conduct are appropriate and justified by the available evidence. This will help to ensure that the limited resources available to DDU for the review and investigation of cases are applied to best effect
- ensures that it assesses and processes Reports of unfit conduct on a timely basis. If Reports are not processed within the statutory two-year time limit, directors who should be disqualified will not have proceedings taken against them.

Procedures for Validating Returns of No Unfit Conduct

3.4 All Returns contain details about the company (including its name, nature of business, date of incorporation and relevant date) and its directors (name, date of birth, duties in the company, period as a director).

3.5 Insolvency Practitioners are not required under the legislation to provide additional information – such as the company history, the nature and size of insolvency or the nature and extent of their findings on the directors' conduct – but are required to sign off on the Return that they are not aware of any matters requiring a report of unfit conduct[6].

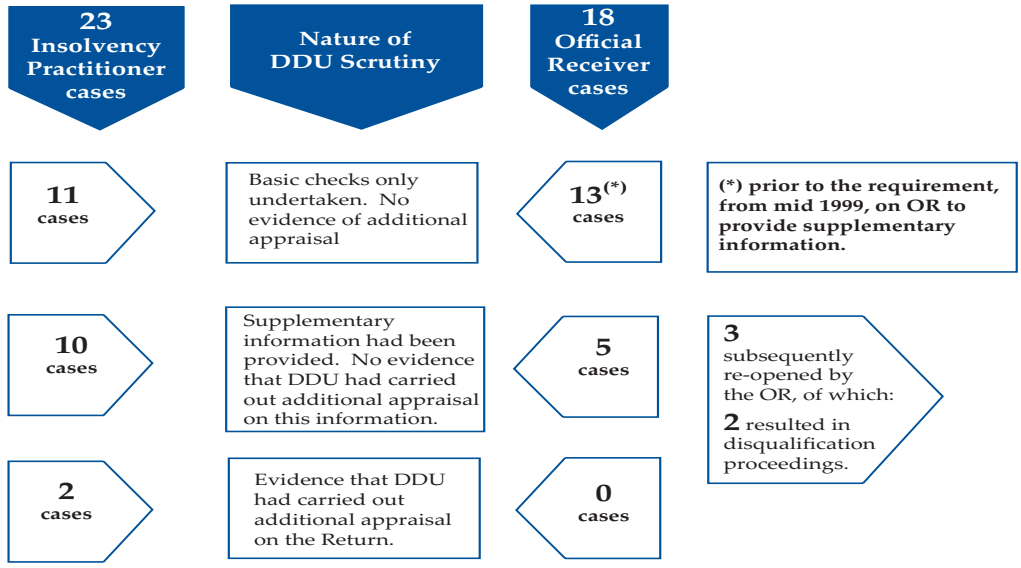
3.6 By contrast, from mid-1999, the Official Receiver's Returns provide supplementary information including the size of deficiency, the reasons for insolvency and the extent of complaints from creditors (**Appendix 3**). The OR signs off that there are no matters requiring a Report of unfit conduct.

DDU's Standard Checking Procedure

3.7 To examine the extent to which the DDU appraised Returns and satisfied itself that they were soundly-based, we reviewed a sample of 41 Returns (23 from Insolvency Practitioners and 18 from the Official Receiver – representing, respectively, 5 per cent and 4 per cent of their total number of Returns). This review indicated (**Figure 13**) that, in the majority of cases, DDU only undertook the basic checks (paragraph 3.3) and there was no evidence that the unit performed any additional appraisal. Even where supplementary information was provided by practitioners, there was no evidence that it was used to appraise the validity of the opinion.

3.8 The above review suggested to us that there is scope to enhance the way in which the Insolvency Service appraises Return submissions. While the Official Receiver's Returns are required to include supplementary information, this has not always proved sufficient to provide DDU with the necessary assurance that his opinion was correct.

Figure 13: DDU's assessment of practitioners' Returns of no unfit conduct



Source: Insolvency Service

6 Since NIAO's fieldwork, DDU now requests Insolvency Practitioners to provide copies of the 'Meeting of Creditors' - this provides the Directors' summary of the financial statements, company history and reasons for failure, statement of affairs (the financial position as at the relevant date) and a deficiency account (a statement reconciling the net assets at the last accounts with the estimated deficiency in the statement of affairs). However, this still falls short of the range of information required by DDU in Official Receiver cases.

Case Study Illustration F

In three of the 18 cases we reviewed, DDU had accepted the Returns of no unfit conduct from the Official Receiver and had closed the cases as requiring no further action. The Official Receiver subsequently re-opened these cases and proceedings were eventually taken in two of the cases, resulting in the disqualification of two directors for unfit conduct.

DDU was not informed by the Official Receiver that he was re-opening the cases and, as a result, DDU's role in deciding the public interest in taking proceedings and commenting on the draft affidavit was by-passed.

In the two cases where disqualifications were obtained, a number of matters for disqualification were known about when the Return of no unfit conduct was compiled but there was no requirement, on the reporting pro-forma, to inform DDU about them.

This is evidenced by the fact that a number of cases which DDU had closed as requiring no further action, following receipt of the OR's Returns, were subsequently re-opened by the OR and resulted in disqualifications (**Case Study Illustration F**).

3.9 These cases illustrated a need for the OR to provide more comprehensive information to DDU with their Returns. The Department told us that, in March 2001, in recognition of this need, Insolvency Service introduced a more comprehensive pro forma (**Appendix 3 (b)**). It said that this now provides a greater level of assurance to DDU on the OR's opinions of no unfit conduct.

3.10 There is a marked difference between the information submitted by Insolvency Practitioners and the OR (paragraphs 3.5 and 3.6), in support of their opinion of no unfit conduct. For Insolvency Practitioners, DDU generally relies entirely on their opinion of no unfit conduct without any substantive information on the individual cases. Even where supplementary information is provided at the Insolvency Practitioner's initiative, there is no evidence that any use is made of it by DDU. The Department told us that the general approach is to rely on the professional opinion of Insolvency Practitioners. In our view, there would be greater assurance to DDU on Insolvency Practitioner cases if, as a standard procedure, a more comprehensive set of information was provided in all cases.

3.11 We recommend that the Insolvency Service reviews its information requirements from Insolvency Practitioners. This need not be an administrative burden on Insolvency Practitioners since the information should be available when they are forming their opinions - for example, it could take a similar form to the supplementary information currently required from the Official Receiver when submitting a Return of no unfit conduct - see Appendix 3 (b).

3.12 The Department has said that there are difficulties with this recommendation, not least the current legislative position that only requires Insolvency Practitioners to complete a standard form of 'Return' or 'Report'. The Insolvency Service believes that this recommendation will be fiercely resisted by the profession, or only accepted if Insolvency Practitioners are paid for the additional work. It said that, where an insolvent estate has funds, the Insolvency Practitioner will take his payment from these funds, at the expense of creditors, and where the estate has insufficient funds then payment will be sought from Insolvency Service which in practice will mean the public purse.

3.13 In our view, this is a matter worth pursuing and we suggest that the Insolvency Service explores the issue with the Insolvency Service in Great Britain and with the RPBs. We note that, in our own dealings with Insolvency Practitioners, both during interviews and in response to our survey questionnaire, we found them keen to engage with the Insolvency Service to ensure that unfit directors are disqualified.

3.14 After a series of Workshops in March 2005, the Insolvency Service encouraged Insolvency Practitioners to supply additional information and this has resulted in some Insolvency Practitioners supplying information to DDU which is similar to that supplied by the Official Receiver.

Procedures for Spot Checks

3.15 DDU used to carry out 'spot checks' of selected Returns to ensure that a common standard was applied between Insolvency Practitioners and the Official Receiver. This entailed a review of Insolvency Practitioners' case files and an investigation to determine if their opinion of no unfit conduct was appropriate. During our review, we noted that DDU had undertaken only 22 spot checks of the 885 Returns received in total by December 2001. We were told that these checks were not a priority for DDU, given the resource pressures from its essential work. Subsequent to our review, we were told that this control had, in effect, been discontinued because the results had confirmed the original decisions of the Insolvency Practitioners in all cases but one. (In this case, DDU's spot check resulted in a successful application for disqualification of two directors for five and seven years respectively. The case had been chosen because three related companies had gone into liquidation.) The Department told us that, as a result, Insolvency Service now gives a high priority to cases where directors have been involved in other insolvencies.

3.16 In our view, Insolvency Service should re-introduce its spot checking process. Spot checks are a useful source of independent assurance and are recognised as good practice. Checks should be based on a formal risk assessment procedure, with an adequate level of staff resources specifically allocated. Any weaknesses and areas for improvement identified could be disseminated to Insolvency Practitioners.

Procedures for Appraising Reports of Unfit Conduct

3.17 Because of differing legislative requirements, there is a difference in the content and in DDU's treatment of Reports received from Insolvency Practitioners and the OR. The Official Receiver has to undertake a specific investigation into the conduct of directors involved in cases of compulsory winding-up, whereas Insolvency Practitioners are required to consider and report on those matters of unfit conduct which are evident from information acquired in the normal course of their duties in cases of voluntary winding-up.

Reports from Insolvency Practitioners

3.18 Insolvency Practitioners' Reports provide basic information on the company and its directors and also list all the matters of unfitness together with possible mitigating factors. The submissions also include copies of the Statement of Affairs (a sworn statement of the assets and liabilities at winding up), the last three sets of full financial accounts, the Insolvency Practitioner's report to the creditors and any questionnaire which has been completed by the directors. However, there is no requirement to provide detailed supporting evidence to corroborate the basis of their opinion.

3.19 DDU carries out its own independent investigation into the directors' conduct, using the Insolvency Practitioners' Reports and drawing on any information held by them and relevant third parties. If it decides to undertake proceedings, DDU prepares and agrees an affidavit with the Departmental Solicitor and, as the insolvency office-holder, the Insolvency Practitioner is required to swear the affidavit (and may be called to give oral evidence and be cross-examined in the High Court).

Reports from the Official Receiver

3.20 DDU's processing of Reports from the Official Receiver differs in two fundamental ways. First, DDU does not carry out its own direct investigations but relies on its review of the Report and the detailed findings from the Official Receiver's investigation into directors' conduct. It can raise questions and seek additional information from the Official Receiver to aid its decision on the

Figure 14: Progress of the OR and Insolvency Practitioners' cases

Targets	Performance Official Receiver	Performance Insolvency Practitioners
DDU to: - complete its investigation into Insolvency Practitioner cases within 3 months of commencement. - complete its review of OR cases within 3 weeks of receipt of all appropriate information.	Achieved in 9 of 13 cases	Achieved in 15 of 15 cases
To submit draft affadavit to DDU for review by 15 months (for OR only, no target for DDU to complete internal drafts in IP cases).	Achieved in 0 out of 4 cases going to draft affidavit	Achieved in 3 of 6 cases going to draft affidavit
To submit all affadavits to the Departmental Solicitor by 21 months (*).	Achieved in 1 of 3 cases going to Departmental Solicitor	Achieved in 5 of 6 cases going to Departmental Solicitor
To sign and file all affidavits in court within two years.	Achieved in 3 of 3 cases going to court proceedings	Achieved in 6 of 6 cases going to court proceedings

(*) This is also a Corporate Plan Target (see Figure 3, paragraph 1.9). Actual outcome has generally failed to meet the target.

Source: Insolvency Service

'public interest' of proceedings. Second, if it agrees to undertake proceedings, it is the Official Receiver staff who draft (with the guidance and direction of DDU) and sign off the affidavit.

Target Deadlines

3.21 The Insolvency Service has a statutory deadline to file applications for disqualification with the High Court within two years from the relevant date of the insolvency and has also established a number of interim operational targets to ensure this deadline is met. To determine whether the Insolvency Service was meeting these deadlines, we reviewed the progress of a sample of 28 Reports – 15 from Insolvency Practitioners and 13 from the Official Receiver (**Figure 14**).

3.22 In our sample, all affidavits submitted by DDU to the Departmental Solicitor were completed within the two-year statutory deadline and resulted in disqualifications. However, it is evident that, in a significant proportion of cases, the Insolvency Service has not managed to meet its internal administrative deadlines and its corporate target

of submitting all affidavits to the Departmental Solicitor within 21 months (see paragraph 1.9 and Figure 3). The Insolvency Service told us that new operational targets were introduced in 2002-2003 for the submission of the draft affidavits to DDU – it was to receive the first draft within 15 months in 2002-2003, reduced to 12 months in 2003-2004; and the final draft affidavit within 18 months in both 2002-2003 and 2003-2004. We noted that, over the two-year period, only four of 14 first draft affidavits were within target, and none of the 15 final draft affidavits produced in the period met the target.

3.23 The Insolvency Service also told us that since August 2004 they have set an internal target for the DDU to complete a first draft of an affidavit (in Insolvency Practitioner cases) within eight weeks of an instruction from the Senior Examiner. There is also an operating plan target for DDU to lodge a draft affidavit and exhibits with the Departmental Solicitor's Office within 18 months from the relevant date and, in all cases identified as being suitable for disqualification proceedings, to issue such proceedings or enter into an undertaking with the director(s) within the two-year statutory limit.

3.24 Failing to meet deadlines inevitably puts pressure on the disqualification process and creates the risk that appropriate cases for disqualification are not progressed because they run out of time. Our review of a separate sample of 35 cases noted three instances (**Case Study Illustrations G, H and I**) where the cases appeared to be overlooked, investigations were not completed or inadequate time was left to clear points raised by the Departmental Solicitor with the consequence that disqualification cases were not pursued.

3.25 We are concerned that Cases G and H, which had prima facie evidence of unfit conduct, did not progress further within the Insolvency Service and did not receive appropriate consideration for disqualification proceedings. We also note that in Case I, DDU had ran out of time without undertaking the required investigation. These cases were not well managed within the Insolvency Service and, in our view, controls should have been in place to prevent them from slipping into prolonged periods of inaction.

Case Study Illustration G - Estimated deficiency to creditors: £137,000

The OR submitted a Report of unfit conduct citing 4 matters for determining unfitness of the company director. DDU reviewed the submission and indicated that *"… this has considerable potential for proceedings based on the following allegations…"* and proceeded to list 6 specific allegations.

There was a series of exchanges of information between DDU and the OR leading to a draft affidavit being submitted by the OR to DDU on 16th September 1999. The draft affidavit set out the Department's case for the director's unfitness, indicating that he:

- caused the company to trade until January 1998 when he knew or ought to have known that it was insolvent by September 1997 at the latest
- caused the company to retain funds of around £126,000 which were properly payable to the Crown and financed the continued period of insolvent trading by the retention of these monies
- failed to co-operate fully with the OR in the provision of a Statement of Affairs and in returning a signed copy of his narrative statement.

DDU called two meetings with the OR staff to progress the draft affidavit – for 30th September and 22nd November 1999 - however, neither meeting took place.

A note from the OR examiner (dated 12th May 2000) stated that he had heard nothing further about the case after the arrangement to meet on 22nd November 1999, that the two year period had now expired and queried whether it was in order to close the case.

The case was closed with no evidence of any work being done on the draft affidavit by DDU.

Case Study Illustration H - Estimated deficiency to creditors: £80,000

The OR submitted the Report of unfit conduct on 29th May 1998. In response, DDU wrote to the Official Receiver (2nd July 1998) raising a number of matters for follow-up by the OR examiner, and indicating that there was *"…a case to answer and I await your further Report with interest"*.

DDU issued reminders to the examiner via the Official Receiver on 21st September and again on the 13th October 1998.

No replies from the Official Receiver unit were received by DDU who ultimately designated the case as requiring *'no further action'* on 22nd September 1999 when the 2-year period for initiating disqualification proceedings elapsed.

Case Study Illustration I - Estimated deficiency to creditors: £2,834,000

The Insolvency Practitioner submitted a Report of unfit conduct on 9th March 1999 after a number of extensions to the deadline for submission.

On 10th August 1999 (just 5 months before the 2-year deadline for initiating disqualification proceedings) DDU wrote to the Insolvency Practitioner stating *"…Before we start our investigation... "* seeking updates on a number of lines of enquiry the Insolvency Practitioner had alluded to in his submission. On 23rd September 1999 DDU met with the IP's staff and obtained a 'letter of representation' - this is required to facilitate DDU's enquiries with creditors and interested third parties to the insolvency.

Following the initial meeting with the Insolvency Practitioner's staff on 23rd September 1999 (less than 4 months before expiry of the 2-year deadline for initiating disqualification proceedings) the Insolvency Practitioner provided a breakdown of some figures in the company's accounts (letter of 29th September 1999) and sought updates on the current position of DDU's activity in letters of 1st and 23rd November, 10th December 1999 and 7th February 2000 (the last after the 2-year deadline for the initiation of proceedings). There was no record of any replies on file.

A letter from the Insolvency Practitioner dated 15th February 2000 sought confirmation of DDU's conversation with his staff member informing him that no disqualification action would be taken. DDU's letter of 18th February 2000 confirmed this – no reasons for the decision were provided.

There was no evidence on file of DDU's investigation into this case other than the letters indicating a meeting took place between DDU and Insolvency Practitioner staff and the additional breakdown of the accounts figures by the Insolvency Practitioner.

NIAO was told by DDU that the case ran out of time.

3.26 The internal review of the Official Receiver Unit (see paragraphs 2.44 - 2.47) identified many instances where OR staff failed to respond to queries from DDU staff and recommended that the Official Receiver must respond in a timely and substantive manner. There is also evidence from our own case work (**Case Study Illustrations J and K**) corroborating that there had been internal communication difficulties of this nature within the Insolvency Service.

Case Study Illustration J - Estimated deficiency to creditors: £583,000

Although DDU ultimately determined that there was insufficient evidence of unfit conduct in this instance, there is evidence of lack of internal communication between DDU and the OR.

Following the receipt of a Report of unfit conduct on 26th October 2000, DDU held discussions with the OR examiner and subsequently issued a memo (27th November 2000) to the examiner – this stated that it had been agreed to interview one of the directors again on the specifics of the company's trading and assets etc; that DDU would review the case again in late January 2001; and DDU asked to be kept informed of any developments.

DDU sought an update on developments in the case in a memo to the OR examiner dated 29th January 2001. It took a further 9 memos between 16th March and 22nd October 2001 to elicit a response dated 25th October 2001.

Case Study Illustration K - Estimated deficiency to creditors: £364,000

DDU authorised the OR's unit to proceed with drafting an affidavit on the 14th August 1997, and offered its assistance should they feel it appropriate. On the 17th November DDU issued a reminder to the OR that 3 months had passed since this authorisation, and asking when a first draft could be expected. The OR informed DDU that the examiner was on sick leave, but that they were aware of the case and its deadline.

On 23rd January 1998, DDU expressed concern that drafting of the affidavit had not commenced and whether it could be finalised by the 2-year deadline (24th June 1998). DDU sought information on the OR's progress and any difficulties with the draft on the 23rd January, 30th March and 7th May 1998 before receiving a response dated 29th May 1998 that there was insufficient evidence to proceed with a draft affidavit. DDU made a recommendation for no further action on 18th June 1998 (6 days before the 2-year deadline).

3.27 The Insolvency Service has generally failed to meet its published performance target of submitting draft affidavits to the Departmental Solicitor within 21 months. Our case studies found that cases appeared to be overlooked, investigations were incomplete or were not progressed sufficiently to make conclusions on directors' conduct or inadequate time was left within the two-year period to clear points raised by the Departmental Solicitor. In our view, it is essential that the Directors Disqualification Unit and the Official Receiver communicates effectively and maintain a good working relationship. They need to ensure that deadlines for submissions of Reports and Returns are rigidly adhered to and must establish and enforce administrative deadlines so that OR staff reply to DDU queries in a timely manner and do not allow cases to experience prolonged periods of inactivity. We also suggest that the Service monitors the effectiveness of these procedures and establishes the extent to which cases are not processed on a timely basis, together with the reasons.

3.28 The Department has agreed our recommendations and said that the Insolvency Service is proceeding to strengthen DDU with appropriate staffing and other resources, including information technology, to enhance existing information systems and performance summaries. In addition, the Official Receiver and DDU are now monitoring the timeliness of replies to enquiries, by meeting on a regular basis (since July 2004).

Case Management Procedures for Insolvency Practitioners' Reports

3.29 DDU has direct responsibility for the investigation of directors' conduct and for preparing affidavits in Insolvency Practitioner cases. For these cases, it is therefore particularly important that it has in place appropriate systems of planning, monitoring and control, and is adequately resourced to discharge its functions.

Planning

3.30 A DDU senior examiner undertakes an initial review of the Insolvency Practitioner's Report and associated papers and provides a brief for the investigating examiner. Investigating examiners are allocated cases by a senior examiner. The Insolvency Service told us that an examiner typically works on 3 to 4 cases at a time with a target to submit a report and recommendation within three months of taking the case.

3.31 In our view, there is scope to improve the planning process in a number of ways. We noted for example that:

- it is standard practice for the Insolvency Service to investigate all Reports
- the DDU senior examiner's brief was the only planning paper on file and the detail on how the investigation was to be undertaken was left to the examiner and not documented in advance
- there was no prioritisation of cases
- DDU does not routinely undertake preliminary discussions with the relevant Insolvency Practitioners to inform its approach to the investigations.

The Department told us that its examiners, who are all professionally trained, carry out investigations appropriate to the circumstances of each case and consult with the relevant Insolvency Practitioners where they consider it to be appropriate.

3.32 By contrast, we note that in Great Britain the Insolvency Service only investigates those Reports which have been vetted, by experienced examiners led by a senior examiner, and considered likely to go to proceedings. This aims to identify cases with prima facie evidence of unfit conduct and thereby avoids wasting resources on investigating directors whose conduct is least likely to merit disqualification. The Insolvency Service in GB also liaises with the relevant Insolvency Practitioner when planning an investigation to increase its understanding of, and inform its approach to, the investigation.

3.33 We recommend that the Insolvency Service should consider adopting a similar approach to that in Great Britain. Experienced examiners should undertake an initial prior appraisal to vet each Insolvency Practitioner Report and thereby recommend whether to further investigate the directors' conduct. The Insolvency Service should also, at an early stage, discuss the case with the relevant Insolvency Practitioner to provide a fuller understanding of the nature and extent of evidence within the Report. It would also be useful if the Insolvency Service monitored trends in individual Insolvency Practitioners' Reports (the proportion resulting in disqualification) to inform its overall planning. Such an approach should enable the Insolvency Service to reduce the number of detailed investigations, save specialist resources and more effectively exercise its responsibility for determining the 'public interest' in taking disqualification proceedings.

3.34 The Department told us that the Insolvency Service, following a visit to benchmark its procedures against those of the Insolvency Service in Great Britain, is considering how best to introduce a similar approach. As a first step, it commenced quarterly monitoring of the trends in individual Practitioners' Reports at the end of 2004.

Monitoring and control

3.35 Our case study review suggests that there is scope for the Insolvency Service to undertake more pro-active monitoring and control. We noted that investigations proceeded with little input from the senior examiner (we found only one case in our sample where there was evidence on file that the examiner had submitted a progress report for consideration and review by the senior examiner).

3.36 We also noted that, unless DDU seeks specific legal advice about aspects of the case, the Departmental Solicitor usually only becomes involved when the draft affidavit is presented for consideration and recommendation, often within weeks of the two-year deadline. In only one of the

13 cases reviewed, where affidavits were drafted, did the solicitor have any input prior to receiving the draft affidavit for review. Yet in all the cases examined, the solicitor's reviews raised material issues requiring DDU to acquire new additional information or review existing information. These changes then had to be addressed in a particularly challenging timeframe.

3.37 We put it to the Insolvency Service that its monitoring and control of the processing of Insolvency Practitioners' Reports would be strengthened if senior examiners undertook formal interim reviews of cases on a periodic basis and provided specific written advice and guidance on what needed to be investigated and whether it was worth proceeding further with the investigation.

3.38 Insolvency Service said that, from December 2004, senior examiners are now planning investigations, highlighting the issues to be addressed. They are also carrying out interim and final reviews of the investigation.

3.39 We also suggested that the process would be further strengthened if the Departmental Solicitor was involved at an earlier stage in the investigation and in the drafting of affidavits to identify and deal with potential problem areas earlier in the process and reduce the risks inherent in clearing reports and affidavits so close to the two-year deadline. The Department commented that the Departmental Solicitor is, as a matter of course, consulted where it is considered that specific advice is needed early in a case or where a case appears to be 'borderline'. It said that, until the Insolvency Service has all the evidence and facts on a case, the Departmental Solicitor would not be able to make a fully informed decision. The Insolvency Service said that it intended to provide more time for the Departmental Solicitor's review by setting a target for the submission of the final affidavit to the solicitor by month 18 (commencing with cases with 'relevant dates' from April 2004).

3.40 In our view, the participation of the Departmental Solicitor in DDU's review and quality assurance processes, albeit towards the end of the investigation or in the early stages of drafting the affidavit, would ensure an early consensus view on the robustness of the case and the key matters to be brought to the affidavit. This should improve the quality of the DDU draft affidavits as well as facilitating the Departmental Solicitor's review of the affidavits within a challenging timeframe.

Resources

3.41 DDU's ability to manage and progress cases depends to a large extent on its staff resources. Indeed, the Insolvency Service told us that staff shortages in DDU was a primary reason why, for a prolonged period, it had not met its corporate target for submissions to the Departmental Solicitor (**see Figure 3**). During the period from 1999 to 2001, it was unable to fill a vacancy at examiner level for a period of 20 months which, given its complement of three examiners, was a significant reduction in staff resources. Normally, vacancies are filled by transfers of experienced staff from the Official Receiver's unit but this was not possible because of the latter's own staffing needs. DDU continues to have difficulty in obtaining its staff complement and has experienced difficulties in replacing an Examiner with a part-time Trainee Examiner.

3.42 Given the specialist nature of the Insolvency Service's work and its relatively small size, it is clear that it would be under considerable pressure to investigate directors' conduct and progress applications for disqualifications if company insolvencies were to increase or if it lost specialist staff.

3.43 In our view, the Insolvency Service must develop contingency plans to deal with unforeseen fluctuations in its future workload or reductions in staff numbers. We note, for example, that in Great Britain the Insolvency Service uses private sector solicitors to carry out some investigations into directors' conduct and to draft affidavits. We recommend that the Insolvency Service explores the feasibility of this option in Northern Ireland.

3.44 The Insolvency Service said that it has had discussions with the Insolvency Service in Great Britain as part of its consideration of this recommendation.

Part 4

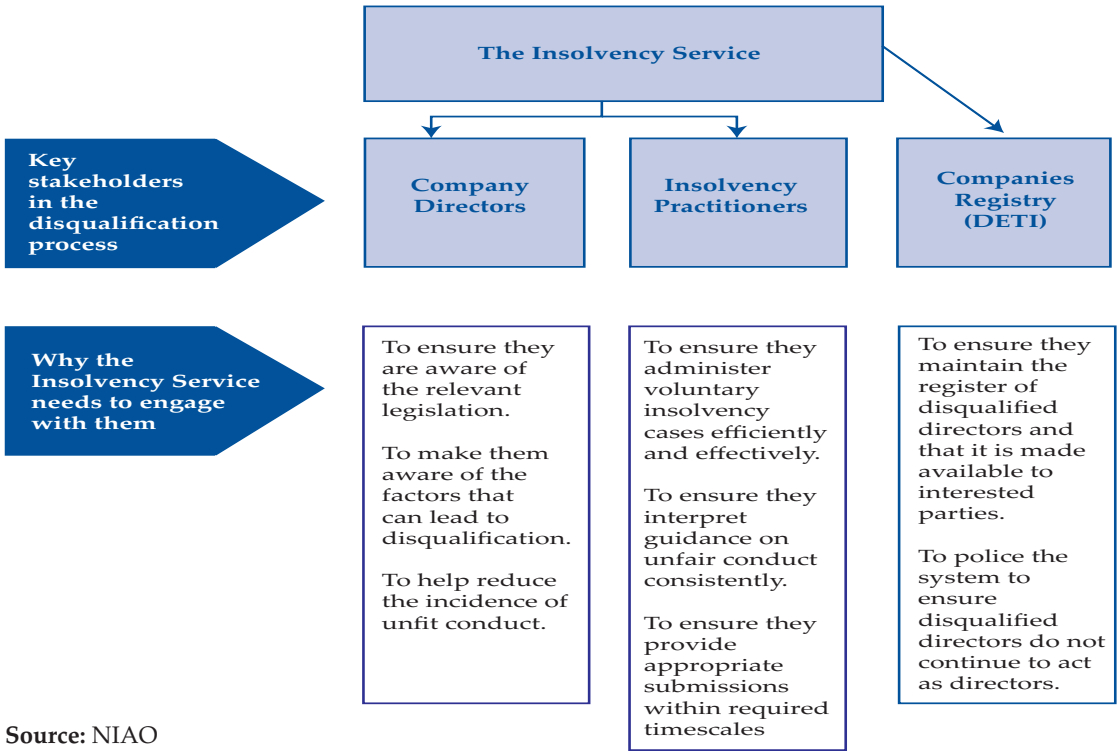
Engagement with External Stakeholders

Background

4.1 Company insolvencies can have widespread economic impacts. Over the period October 1991 to March 2005, the average net deficiency per company insolvency in Northern Ireland was of the order of £185,000. The Crown (HM Revenue and Customs) and business suppliers are the types of creditors most likely to lose money as a result of insolvencies (usually the financial institutions who lend capital have secured their loans against the companies' assets or guarantees from directors, while shareholders losses are limited to the amount they invested in the company). Our survey of company directors (see paragraph 4.3) illustrated the effects of insolvencies on the wider business community – over a half (54 per cent) of directors reported their companies had experienced losses as a result of other companies' insolvencies and many of these indicated that the losses had had a significant impact on their companies.

4.2 Efficient and effective implementation of directors' disqualification legislation can act as an important deterrent in preventing unfit conduct by company directors, thereby helping to reduce company insolvencies caused by unfit conduct and alleviate the wider economic consequences to the Crown and other businesses. To administer directors' disqualification legislation effectively, we believe it is important that the Insolvency Service has appropriate structures in place to engage with key stakeholders affected by the legislation. In particular, it is important that the Insolvency Service engages effectively with company directors, Insolvency Practitioners and with the Companies Registry (**Figure 15**).

Figure 15: Key Stakeholders and their Importance to the Insolvency Service



Source: NIAO

Company Directors

4.3 We commissioned a survey of 200 company directors in Northern Ireland. The purpose of this survey was to assess their awareness of the company director disqualification legislation and process, to gauge their perceptions on the implementation of the legislation and to measure their awareness of the Insolvency Service and its role and responsibilities (**Figure 2**).

4.4 Overall, our survey found that the majority of directors felt well-informed about the responsibilities of a director and the factors that could lead to their disqualification under the Companies Order. However, there was a significant proportion of directors who did not feel well-informed about their duties and responsibilities, had not received formal information about the disqualification process, considered that the implementation of the legislation was generally not effective and had not heard of the Insolvency Service or had limited understanding of its responsibilities.

Awareness of the Director Disqualification Legislation and Process

4.5 A significant proportion of company directors indicated that they do not feel well informed about their duties and responsibilities as defined by the legislation (**Figure 16**). Ten per cent indicated that they were not informed at all and a further 31 per cent that they felt not very well informed.

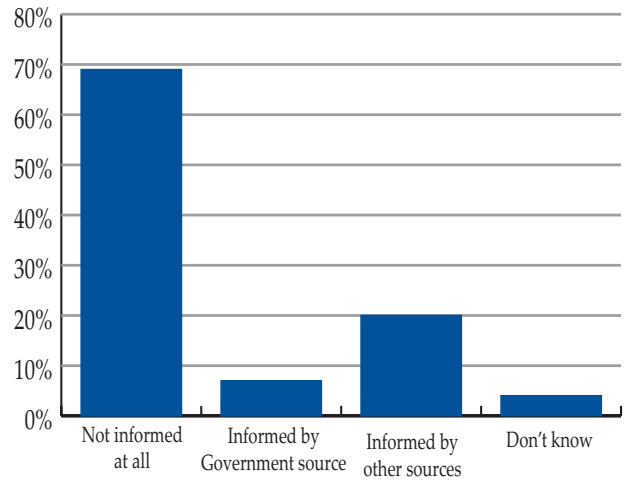
4.6 The majority (61 per cent) of survey respondents indicated that they felt very well or quite well informed about the factors that could lead to their disqualification under the Companies Order. However, a further 25 per cent felt not very well informed and 12 per cent not informed at all about such factors.

Figure 16: Directors' awareness of their duties and responsibilities and factors leading to disqualification

Source: NIAO

4.7 NIAO's survey asked directors if they recalled being given any formal, written information about the circumstances in which a company director can be disqualified and the procedures for enforcing such disqualification. Over two-thirds (69 per cent) of respondents indicated they were not informed at all. Only 7 per cent of those surveyed indicated that they had been given formal information from Government Departments (**Figure 17**).

Figure 17: The extent to which Directors were informed about disqualification

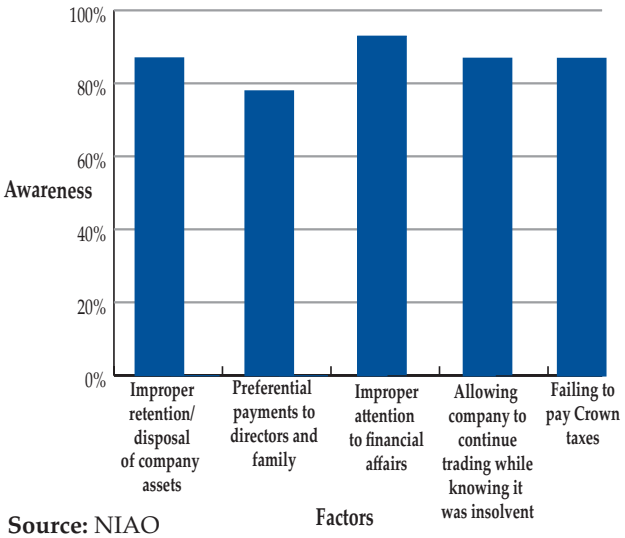


Source: NIAO

Unfit Conduct

4.8 There are 5 main ways in which a director of a failed company can be considered unfit. Our survey asked respondents if they were familiar with any of them. Overall, 5 per cent of directors surveyed indicated that they were unfamiliar with any of them and, on average, over 10 per cent were unfamiliar with any given individual reason for disqualification (**Figure 18**).

Figure 18: Directors' awareness of factors constituting unfit conduct



Source: NIAO

4.9 The survey results also indicate that a significant proportion of directors are not familiar with issues such as to whom disqualification applies and what it actually means in practice. For example:

- 70 per cent did not recognise that disqualification actually applies to all those directors who were, or should have been aware of the misconduct
- approximately 30 per cent did not recognise that the director is disqualified from acting as a director of *any* company
- 85 per cent were not aware of the penalties for continuing to act as a director while disqualified.

Perceptions on the Implementation of the Legislation

4.10 We asked directors how successful they believed the Insolvency Service's implementation of the disqualification legislation had been for each of its three objectives of removing unfit directors, protecting the public's interest and deterring director misconduct. Between one quarter and one third of directors indicated that they did not know, but the majority of those offering an opinion indicated that the implementation of the legislation was generally not successful:

- 45 per cent considered it was not very or not at all successful in removing unfit directors against 20 per cent who thought it was very or quite successful in achieving this objective (35 per cent were 'don't know')

- 41 per cent indicated it was not very or not at all successful in protecting the public's interests whereas 34 per cent considered it very or quite successful in this regard (25 per cent were 'don't know')

- 38 per cent believed it was not very or not at all successful in deterring directors' misconduct compared with 33 per cent who thought it was very or quite successful (29 per cent were 'don't know').

4.11 Overall, more than half of those directors surveyed who gave an opinion suggested that the legislation has little impact on the way directors conduct their business (56 per cent agreeing strongly/slightly against 34 per cent disagreeing strongly/slightly); indicated that the chance of getting caught is so minimal that the legislation is not effective in meeting its objectives (57 per cent agreeing and 28 per cent disagreeing); and agreed that the legislation is not enforced rigorously enough to prevent disqualified directors from continuing in their role (59 per cent agreeing, 17 per cent disagreeing).

4.12 Directors were more evenly split in their opinion on whether penalties were severe enough to deter directors from behaving responsibly – 38 per cent agreeing and the same proportion disagreeing with this statement.

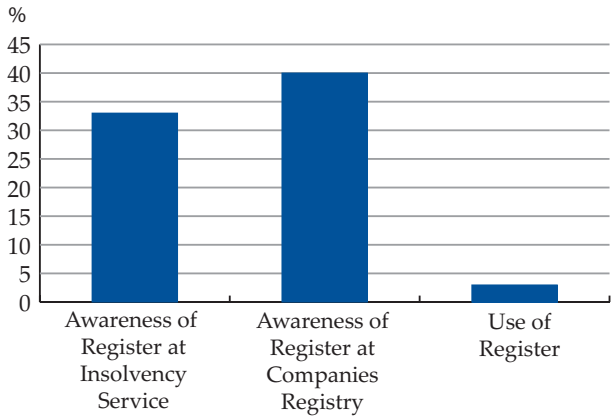
4.13 Despite the generally negative balance of opinions on the implementation of the disqualification legislation, over three-quarters (78 per cent) of those surveyed agreed strongly/slightly that the legislation did offer a deterrent against unfit conduct. There was also a clear recognition that arrangements need to be in place to disqualify directors who are unfit to manage (approximately 90 per cent of survey respondents agreeing with this statement).

Awareness of the Insolvency Service

4.14 While a majority (58 per cent) of those surveyed had heard of the Insolvency Service, a significant 42 per cent had not. However, even among those who had heard of the Insolvency Service, there was a lack of understanding of its responsibilities. For example, almost a third of these respondents were unaware that Insolvency Service administered the affairs of bankrupts or handled the disqualification of directors in company insolvencies. Over a quarter of these respondents mistakenly believed that Insolvency Service was responsible for the registration of company directors and for the filing of company returns and accounts.

4.15 Only one in three of the directors we surveyed were aware that there is a register of disqualified directors accessible to the public at the Insolvency Service in Belfast – a greater proportion (40 per cent) was aware that Companies Registry also had such a register. Even of those aware of the existence of a register, there was very little use of it. Less than 5 per cent of these respondents had ever inspected the register (**Figure 19**).

Figure 19: Directors' awareness and use of the Register of disqualified directors



Source: NIAO

4.16 Our survey indicates that a significant proportion of directors is unaware of the relevant disqualification legislation and of the role and responsibilities of the Insolvency Service. We therefore believe that there is scope for the Insolvency Service to improve its communication with company directors and to disseminate key information more effectively. This could in part be achieved through the wider agencies of the Department, such as Companies Registry and Invest Northern Ireland, which deal directly with the business sector and individual directors, and the Service should consider drawing up a joint action plan with the other parts of the Department. The Insolvency Service should also consider using electronic means, such as putting the register of disqualified directors and other information on the Department's web site.

4.17 The Insolvency Service told us that guidance leaflets for company directors would be put on the Companies Registry website from the start of 2005 and that a register of disqualified directors will become available at the end of 2005. Companies Registry is considering other initiatives to improve communication with company directors.

Insolvency Practitioners

4.18 We surveyed the 48 Insolvency Practitioners currently registered and based in Northern Ireland, receiving replies from 23 of them, and also conducted structured interviews with five. We used the information to consider the nature of the relationship between the Insolvency Service and Practitioners; to gauge Practitioners' views on whether or not disqualification procedures were operating effectively and whether the Insolvency Service was successful in implementing the legislation; and to explore what quality assurance procedures Insolvency Practitioners themselves used in the disqualification element of their insolvency work (**Appendix 2**).

Relationship with the Insolvency Service

4.19 Our discussions with Insolvency Practitioners, together with our survey findings, suggest that there is scope for the Insolvency Service to improve its communication during and after the processing of individual cases. Although Insolvency Service provides feedback to Practitioners on each Report received and the majority of Insolvency Practitioners surveyed (78 per cent) considered this feedback to be very or quite valuable, a significant minority (22 per cent) considered it to be not very or not at all valuable.

4.20 The Insolvency Practitioners also indicated that, where DDU decides to actively investigate directors' conduct, it should commence soon after the Practitioner has made the submission, before they have moved on to other cases and before papers have been filed away. All the Insolvency Practitioners surveyed indicated that they would welcome direct contact with DDU to discuss each case and to contribute to DDU's scoping and methodology of its investigations.

4.21 Insolvency Practitioners told us that they would be interested in establishing regular meetings and/or workshops between themselves (as a group) and the Insolvency Service to receive briefings from the Insolvency Service on any new policies and procedures; clarify guidelines and standards for insolvency work; and to discuss any operational difficulties. They indicated that this would particularly help those who had small numbers of cases to keep abreast of developments and would also improve the standards throughout the profession.

4.22 We recommend that the Insolvency Service responds to the findings from our consultations with Insolvency Practitioners. It should build on its existing arrangements[8] for the dissemination of advice and guidance on insolvency matters and meet with Insolvency Practitioners on a regular cycle to develop common understanding and expectations on all aspects of insolvency work and to clear any

8 The Insolvency Service currently briefs Insolvency Practitioners through 'Dear IP letters'. It also liaises with a Practitioners' representative on its 'user group'. In addition, the Recognised Professional Bodies play a role in the continuous professional development of their members.

operational difficulties. This will contribute to the professional development of both the Insolvency Service and Insolvency Practitioners and should enhance working relationships. DDU should also seek to ensure that it deals with cases in a timely manner, as requested by Practitioners, and consider liaising more pro-actively with them on individual cases.

4.23 The Department agreed with the additional actions recommended and said that the Insolvency Service met with the RPBs in December 2004 to take their views on the frequency and areas for discussion in future meetings with the Insolvency Practitioners. Following the meeting with RPBs, the Insolvency Service held a number of Workshops for Practitioners in March 2005 and these will now be held on an annual basis.

Perceptions on the Insolvency Service's Implementation of the Legislation

4.24 In our survey, we asked the Insolvency Practitioners how successful they felt the Insolvency Service's implementation of the legislation had been in meeting each of its objectives. While the majority of respondents (around two-thirds) considered that the Insolvency Service had been quite successful in its implementation, a substantial minority (about a third) considered it had not been very successful (**Figure 20**).

4.25 Some indication of why they felt this is evident from the views on the Insolvency Service's activity in pursuing disqualifications – 30 per cent considered the Service to be bringing proceedings against a sufficient number of unfit directors (30 per cent considered they were not and 40 per cent did not know); and although 42 per cent considered Insolvency Service acted quickly enough to protect the public interest and creditors, 26 per cent considered they did not act fast enough and 32 per cent did not know.

4.26 A relatively small number of Insolvency Practitioners (5 out of 18 who replied to the question) had experiences of the Insolvency Service not pursuing cases which the Practitioners considered strongly merited disqualification. Three of these Practitioners subsequently queried the Insolvency Service on its decision not to proceed and only one was satisfied with the subsequent response from the Service. Another considered that DDU seemed to deal with the easiest cases of unfit conduct.

4.27 All the survey respondents considered that directors could avoid disqualification (including one who noted that "*..only the foolish get caught*"). A couple of Insolvency Practitioners explained that if the directors delayed their responses to enquiries, lost their company records, produced a medical certificate in mitigation and so forth, it would all help in the avoidance. The majority also suggested that disqualification was not a particularly effective penalty because it could be circumvented by having someone (a family relative for instance) 'fronting' a new company, or the disqualified individual could become a sole trader.

Figure 20: Perceptions on how successful the Insolvency Service's implementation of the legislation is in meeting its key objectives

How successful is the IS's implementation of the legislation in meeting each of the objectives:	Very	Quite	Not very	Not at all	Don't know
Removing unfit directors	-	66%	26%	4%	4%
Protecting the public interest	4%	66%	26%	-	4%
Protecting commercial interests	-	70%	22%	4%	4%
Improving standards of company financial management	4%	57%	26%	9%	4%

Source: NIAO

4.28 The Insolvency Practitioners represent key stakeholders in the disqualification process and their views have significant potential value to the Insolvency Service. It is notable that around a third of them do not believe the Insolvency Service's implementation of the legislation is successful in meeting the legislation's key objectives. In our view, these findings merit consideration and we recommend that the Service consults with Insolvency Practitioners in a more structured and systematic fashion, formally reviews the feedback from this consultation and uses the results to determine whether or not they can improve the effectiveness of their implementation of the disqualification legislation. This should be done with the involvement of the Recognised Professional Bodies. The Insolvency Service has told us that it will meet with the RPBs to discuss these matters.

Quality Assurance Procedures

4.29 As part of our survey, we asked Insolvency Practitioners what procedures they had in place to ensure that their opinion on the possibility of unfit conduct by a director was soundly-based.

4.30 While 16 respondents (70 per cent) used checklists to ensure that their opinion on directors' conduct was soundly-based, only 7 (44 per cent) of the 16 also used independent peer review to provide a check on their opinions. The majority (87 per cent) considered that the Insolvency Service's guidelines, on the type and materiality of conduct to report, were quite or very satisfactory.

4.31 We noted, however, that a small number (two Insolvency Practitioners - 9 per cent - in each case), reported having no formal procedures in place to provide assurances that their opinions were soundly based and had not seen the Insolvency Service's guidelines governing the conduct to be reported.

4.32 It is fundamental to the integrity of the disqualification process that Insolvency Practitioners, who play a key role in voluntary insolvencies, have quality-assurance procedures to ensure their opinions on unfit conduct are soundly-based. The Insolvency Service, working in conjunction with the RPBs, should review the arrangements in place for each Practitioner and provide best-practice guidance to help them improve their quality assurance procedures. As noted at Paragraph 4.23, the Insolvency Service has since met with the RPBs (in December 2004) and has held Workshops for Insolvency Practitioners (March 2005).

The Companies Registry

4.33 The effectiveness of the disqualification process depends to a large extent on the arrangements that are in place to ensure that disqualified directors resign their directorships and are not appointed to new ones within the disqualification period.

4.34 The Companies Registry of the Department of Enterprise, Trade and Investment is responsible for registering companies and directors and maintains a database of disqualified directors. It therefore has a key role to play in ensuring that disqualified directors resign and do not apply for new directorships. The Insolvency Service is a frequent user of the Companies Registry databases, as the information it holds (on companies' backgrounds and trading performance and on directors' details and numbers of directorships) is important for investigations into unfit conduct.

4.35 The Companies Registry told us that, when new companies are formed, it checks '1 in 50' of the named directors against the register of disqualified directors (up to May 2002, it was checking all directors of new companies - the reduction in the level of checking resulted from other pressures of work.) It also checks '1 in 50' of new directors of existing companies to the disqualification register. However, it undertakes no checks that disqualified directors resign their existing directorships.

4.36 In our view, this low level of checking risks not detecting disqualified directors who continue to operate illegally as directors. We reviewed a sample of 40 disqualified directors from Companies Registry's database of live companies. This review identified three individuals who were currently disqualified but remained registered as directors (**Case Study Illustration J**).

Case Study Illustration J

Director 1 - This individual was disqualified from acting as a director in 1998 for a period of 6 years. However, he was a director of a company with the same business activities as his earlier company. This company, although dormant at the time, was registered prior to his disqualification – therefore he had failed to resign his directorship.

Director 2 - This director was disqualified in 1996 for a period of 8 years but remained registered as a director (although the company was dormant). Nevertheless, this again illustrates the failure to ensure resignation of directorship upon disqualification.

Director 3 - This individual was disqualified from acting as a director in 2000 for 7 years. However, he remains registered as a director of a different, active, company. In addition to retaining his directorship, he also acts as the company's honorary auditor. The individual was a director of this other company prior to disqualification.

4.37 Although this is a relatively small number, and the companies involved were not active or had limited activity, we believe that a system of this nature should be completely accurate. The existence of even a small number of disqualified directors who continue to be registered with active companies is of concern and needs to be addressed. We also identified a further six directors whose details on the register were not specific enough to precisely confirm their position.

4.38 Our review of the disqualification register highlights that there is scope to improve its effectiveness. For example, we note that there is currently no unique identifier for directors (such as a national insurance number) and there is no requirement for directors to update the register with any changes in address.

4.39 In our view, Companies Registry should review its levels of checking and other procedures to ensure that new directors of existing and new companies are not currently disqualified and that disqualified directors resign all their existing directorships. In addition, it should review the register and consider introducing a new field, such as national insurance number, which would constitute a unique personal identifier and thereby improve the register's accuracy and transparency. The Insolvency Service told us that all systems and procedures in Companies Registry relating to disqualified directors, including links to the Insolvency Service, are to be reviewed.

4.40 In Great Britain, the Insolvency Service set up a telephone hotline to enable members of the public to report possible contraventions by disqualified directors and bankrupts. In 2000-2001 it took 449 calls which resulted in 232 substantive complaints being received. Following investigation, 88 of these cases were referred to the Official Receiver or other agencies.

4.41 We note the success of the hotline in Great Britain as a means of helping individuals to report suspected breaches of disqualification orders. Although much smaller in scale, we recommend that the Insolvency Service should consider how it can best facilitate reporting by the public, perhaps by establishing a similar arrangement in Northern Ireland, either on its own or linking into the GB hotline. We were told by the Insolvency Service that it is considering the possibility of a hotline service.

Appendices

Appendix 1
(paragraph 1.3)

Matters for Determining Unfitness of Directors - where the Company has become Insolvent

- The extent of the director's responsibility for the causes of the company becoming insolvent
- The extent of the director's responsibility for any failure by the company to supply any goods or services which have been paid for (in whole or in part)
- The extent of the director's responsibility for the company entering into any transaction or giving any preference, being a transaction or preference liable to be set aside under Article 107 or Article 202 to 205 of the Insolvency Order
- The extent of the director's responsibility for any failure by the directors of the company to comply with Article 84 of the Insolvency Order (Article 84 - duty to call creditors' meeting in creditor's voluntary winding up)
- Any failure by the director to comply with any obligation imposed on him by, or under, any of the following provisions of the Insolvency Order:
  - Article 34 (company's statement of affairs in administration)
  - Article 57 (statement of affairs to administrative receiver)
  - Article 85 (directors' duty to attend meeting; statement of affairs in creditors' voluntary winding up)
  - duty of anyone with company's property to deliver it up
  - duty to co-operate with liquidator.

In addition, Matters for Determining Unfitness of Directors in all cases (Solvent and Insolvent Companies)

- Any misfeasance or breach of any fiduciary or other duty by the director in relation to the company i.e. any conduct by a director which was not in the proper interest of the company, the employees or generally worked to the detriment of creditors
- Any misapplication or retention by the director of, or any conduct by the director giving rise to an obligation to account for, any money or other property of the company
- The extent of the director's responsibility for the company entering into any transaction liable to be set aside by the Insolvency (Northern Ireland) Order 1989 i.e. provisions against debt avoidance
- The extent of the director's responsibility for any failure by the company to comply with certain provisions of the Companies Order:
  - companies to keep accounting records (Article 229)
  - where and for how long records to be kept (Article 230)
  - register of directors and secretaries (Article 296)
  - obligation to keep and enter up register of members (Article 360)
  - location of register of members (Article 361)
  - company's duty to make annual return (Articles 371 and 372)
  - time for completion of annual return (Article 373)
  - company's duty to register charges it creates (Article 406)
- The extent of the director's responsibility for any failure by the directors of the company to:
  - prepare annual company accounts
  - sign of balance sheet and documents to be annexed (Articles 235 and 246 respectively of the Companies Order).

Appendix 2
(paragraph 1.15)

NIAO Survey Methodologies

Survey of Company Directors

NIAO engaged a private sector marketing and research company to carry out the survey and report on the findings. The survey was conducted in consultation with the Insolvency Service and the survey questionnaire agreed with it prior to commencement. This was based on a telephone survey of 200 directors of Northern Ireland registered companies and directors. The 200 directors were selected by the marketing and research company to provide a spread geographically (Greater Belfast/rest of NI); by company size (less than 50 employees/more than 50 employees); and by their company responsibilities (company secretary/other director). The survey questions were initially compiled by NIAO and subject to review and agreement with the marketing and research company, our Insolvency Practitioner reference partner and the Insolvency Service. The survey was piloted before the main survey was carried out.

The survey questioned the company directors about:

- the extent of their experience as a director and the position they hold in their company
- how well informed they felt about their duties and responsibilities as a director and were they informed about these
- their awareness of the issues relating to the disqualification of directors for unfit conduct and what disqualification means for an individual
- how successful did they consider the implementation of the legislation to be and how effective is disqualification as a deterrent against unfit behaviour
- their awareness of the Insolvency Service and the register of disqualified directors
- their company's experiences with companies that became insolvent.

NIAO carried out its own survey of the 48 Insolvency Practitioners listed by the Insolvency Service at April 2002. The survey was conducted in consultation with the Insolvency Service and the survey questionnaire agreed with it prior to commencement. The survey was based on:

- a postal survey of the 48 Insolvency Practitioners - responses were received from 23 (48 per cent response rate)
- the survey questions were initially compiled by NIAO and subject to review and agreement with our Insolvency Practitioner reference partner and the Insolvency Service.

Survey of Insolvency Practitioners

The survey sought information in the areas of the Insolvency Practitioners':

- experience and size of practice
- working practices in relation to directors' conduct and its reporting
- nature and experience of their contact with the Insolvency Service
- views on the Insolvency Service's implementation of the legislation
- views on how knowledgeable company directors are about their general responsibilities and the issues leading to disqualification.

Appendix 3
(paragraph 3.6)

Official Receiver's Returns – Supplementary Information

(a) Pro-forma in place from mid-1999 to March 2001

Supporting Form to Accompany Return of No Unfit Conduct (from Official Receiver)

Name of company _____

Deficiency _____

Reasons for insolvency _____

Complaints from creditors _____

Previous insolvency history _____

If all directors have not been interviewed please give their names and reasons _____

Director losses (amounts and whether guarantees, equity or loans etc) _____

Mitigating factors _____

Any other comments

Official Receiver examiner's signature and date

Source: Insolvency Service

(b) Pro-forma in place from March 2001

Name of company

To: OR
Deputy OR
DDU

Background – reasons for insolvency

Statement of Affairs – a review and commentary on any issues arising

Directors – names, appointment dates, nature and extent of involvement in the company

Accounts – a summary of key financial information

Accounting Records – nature and sufficiency of records, whether they satisfy the statutory requirements, who responsible for maintaining the records

Crown Debts – details and age analysis

Age of Debts – details and age analysis

Dishonoured Cheques – details and history of dishonoured cheques

Statutory Records - nature and sufficiency of records, whether they satisfy the statutory requirements, who responsible for maintaining the records

Other Failures – extent of directors' involvement in other failed companies or live companies

Bankruptcy Orders – any current orders made against the directors

Suggested Allegations of Unfitness – nature of any allegations and why a Report is not appropriate

Mitigating Factors – any circumstances which could form part of the 'public interest' in taking disqualification proceedings

Examiner's signature

Date

Source: Insolvency Service

NIAO Reports 2004-05

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The Private Finance Initiative: A Review of the Funding and Management of Three Projects in the Health Sector	HC 205	5 February 2004
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