For businesses and individuals facing the risk of financial distress

What are your options? Where can you obtain information? Who can advise you?
In the current difficult economic environment, with the impact of the international trade tensions, the social unrest and, more recently, the COVID-19 pandemic, it is expected that more companies and individuals could face financial distress. As the courts have been operating on a more restricted basis over the past several weeks, statistics from the Official Receiver's Office (“ORO”) on corporate winding up and bankruptcy petitions, interim orders made, and individual voluntary arrangements entered into may not yet reflect the full picture. However, the community, including the accountancy community, needs to get prepared.

Against this background, companies and individuals should take precautions as far as possible and prepare themselves to cope with the rapidly evolving situation and potential financial impact that may follow. The Restructuring and Insolvency Faculty Executive Committee of the Hong Kong Institute of CPAs feels a responsibility to provide information to the public that may help in this situation. Ultimately, if companies or individuals require help to resolve their difficulties, Hong Kong has a pool of experienced insolvency professionals within both the public and private sectors who stand ready to assist and are able to leverage their expertise, integrity and professionalism.

This guide is also available here in Chinese.
Companies, employers and employees
Companies in distress

There are various debt relief measures available in the market. In circumstances where companies are unable to meet their financial obligations even though their business is viable, directors are encouraged to explore restructuring options that may rehabilitate and safeguard the interests of stakeholders, creditors, employees and others, as early as possible.

First ports of call

- Companies with bank loans facing short-term cash flow constraints and difficulties servicing their debts should consider talking to their lenders.
- A number of banks at this time have indicated a willingness to talk to their customers and may be able to make adjustments to repayment arrangements.
- Some landlords may also be willing to talk to tenants and make specific arrangements in relation to rental payments.

Government assistance

- The government has received approval from the Finance Committee of the Legislative Council (“LegCo”) to set up an Anti-epidemic Fund$^{1}$, which includes provision for financial assistance for some especially hard hit industries, including retail, transport, food licence holders and the convention and exhibition industry.
- Funding has also been approved for a special 100% Loan Guarantee$^{2}$ under the SME Financing Guarantee Scheme, which is intended to cover rents and employee wages for six months, or an element thereof up to HK$2 million, for eligible enterprises.
- Viable businesses suffering short-term cash flow problems may wish to consider their eligibility for support under these schemes, taking note of any relevant application deadlines.

$^{2}$ The HKSAR Government: https://bit.ly/2Jo436x
Restructuring

Business restructuring may be an option. Directors and business owners should consult a restructuring and insolvency professional as early as possible and avoid potential criminal breaches of the law by, for example, continuing to run up further debt with little prospect of paying this back.

Statutory obligations

Directors and business owners need to be aware of and observe their statutory obligations particularly in this difficult business environment. Some important obligations include:

Ensuring payroll is on time

- Payment of wages within 7 days of the end of the wage period according to the Employment Ordinance (“Cap. 57”, sections 23 and 25).
- Failing to pay employees on time may result in directors, senior management or business owners being held personally liable, upon conviction by the court.
- Labour Department statistics show numerous convictions with fines in the last quarter of 2019 alone.

Keeping books and records up to date

- Companies are required to keep accounting records for 7 years under the Companies Ordinance (“Cap. 622”, section 377), as well as under the provisions of the Inland Revenue Ordinance (Cap. 112, section 51C).
- Requirements to keep, and make available for inspection, company records, such as minutes, memorandum, and registers are set out in sections 654, 655 and 657 of Cap. 622.

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4 Hong Kong e-Legislation: [https://bit.ly/33HcC5s](https://bit.ly/33HcC5s)
Directors’ disqualification

If a company goes into liquidation and, following investigation, one or more directors are found to be at serious fault and unfit to be directors, even where criminal prosecutions are not pursued, those directors can be disqualified by the court from being involved in the management of a company for up to 15 years (Cap. 32, Part IVA).

Employees

Senior employees may also be in a position to encourage their employer to take appropriate action if the employer is in financial distress.

Wage protection for employees

- Employees should ensure that they are aware of their rights and the protections available under Cap. 57.
- Resources are available through the Labour Department to assist employees in relation to the protection of wages.

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Individuals
Loss of employment

• If an unincorporated business or a person’s employer goes into insolvency, or employees lose their jobs due to redundancy, this could easily result in personal financial hardship.
• Prolonged delays over the payment of salaries, in the worst-case scenario, may also lead to personal insolvency.

Loan guarantees

• In economic downturns, business owners may be at risk of defaulting on company loans where they have provided personal guarantees.
• Similar risks may arise from guarantees given for personal loans where the principal debtor is in default.

Risk mitigation

• To mitigate financial exposure, individuals should check any financial obligations embedded in contracts or loan agreements, as either a principal debtor or guarantor.
• When faced with an unmanageable debt burden, there are various options that an individual can consider. Apart from debt relief programmes offered in the market, an individual voluntary arrangement (“IVA”, see below) could provide an alternative to declaring bankruptcy.
Debt counselling

- Some non-governmental organizations such as Caritas and the Tung Wah Group of Hospitals offer debt counselling services. These may be helpful to those who are troubled by debts. Their services include consultation on financial issues, case counselling, emotional support and information on debt handling and solutions.

Debt restructuring

- For indebtedness to banks, including credit card debts, borrowers should contact their lender, as banks are often willing to consider debt-restructuring arrangements as an alternative to bankruptcy. Such arrangements may avoid the impact on a debtor’s credit record that results from bankruptcy.

Individual voluntary arrangements

- There are implications that arise from going through a bankruptcy procedure, which may not apply with an IVA. Therefore, before looking to filing a self-petition under the statutory bankruptcy regime, debtors may wish to consider the option of an IVA, which is a formal debt-restructuring scheme under the Bankruptcy Ordinance (“Cap. 6”, sections 20 - 20L).

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Personal bankruptcy

• In the unfortunate circumstances of serious financial distress, where other options are not viable, debtors should consider the bankruptcy regime under Cap. 6.
• It provides rehabilitation relief to debtors with no ability to repay their debts, subject to certain restrictions with which an undischarged bankrupt should comply\(^\text{12}\).
• While a cooperative bankrupt can expect to be discharged from bankruptcy after four years, it is, nevertheless, important to be aware of the implications of being declared bankrupt.
• For example, assets, including real property, will not automatically be returned to a bankrupt upon discharge. The ORO’s website contains a good deal of information, including Frequently Asked Questions about Bankruptcy\(^\text{13}\).

Be aware

Other than the above, debtors may also be approached by, or encouraged to seek out the services of, financial intermediaries offering “informal” debt restructuring arrangements, which often involve taking out further loans negotiated by the agents to pay off existing debts. Debtors should think very carefully before being induced to enter into such arrangements. They will normally require fees to be paid to the financial intermediaries but, in practice, they may merely defer bankruptcy, and the debtor may end up owing a larger debt. The Financial Services and the Treasury Bureau has published advice\(^\text{14}\) on engaging financial intermediaries.

In summary, given the deteriorating economic environment, directors, business owners, employees and members of the public should take steps to prepare themselves for all possible financial eventualities. To reduce the risk of corporate or personal insolvency, they should look into their financial status and put in place measures to mitigate potential exposures. If their situation is already financial distressed, they should stay calm and rational and consider the various options that may be available. Where appropriate, it is advisable to consult counsellors or professional advisers, including qualified and experienced restructuring and insolvency professionals.

Online resources and more information are available from the following organizations:

**Official Receiver’s Office**
Publications on bankruptcy and company winding up:

**Labour Department**
Protection of Wages on Insolvency Fund Board:
Wage Security Division:

**Investor and Financial Education Council - Debt Counselling Services**

**Hong Kong Institute of Certified Public Accountants**
Restructuring and Insolvency Faculty:
Restructuring and Insolvency Faculty Executive Committee:
Hong Kong CPA Practice Directory: