

SHINEWING

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In this issue ...

Thumbnails – hidden treasure!

Forensic examiners are attentive to search for little pieces of evidence to build or break a case; and thumbnails is somewhere to look for hidden treasure.

Personal Bankruptcy - Part Two

If a bankrupt does not cooperate with his trustees for the bankruptcy administration, or even leaves Hong Kong before the making of a bankruptcy order, what can the trustees do? This article will tell you some of the possible solutions.

Things you need to know when managing your China investments

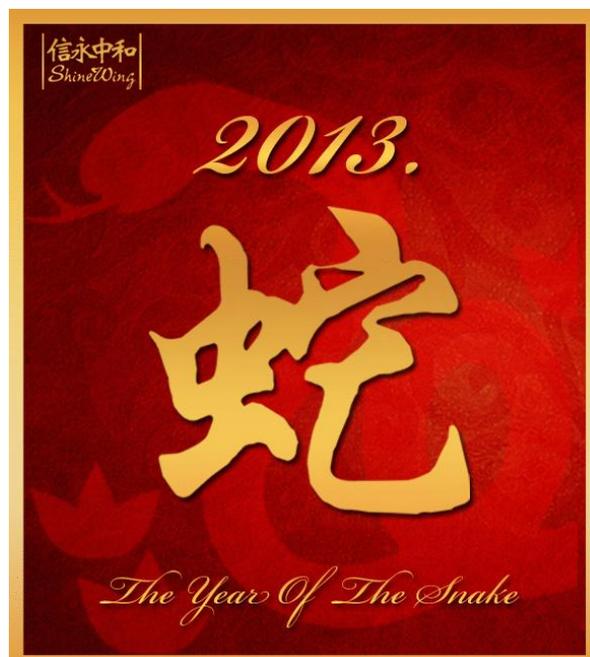
Four key areas that investors may need to pay attention when dealing with their investments in China. What are they?

Knowledge - Recovery and Reorganisation

Three Musketeers in company's insolvency administrations: Provisional liquidators, Liquidators and, Receivers and Managers

SHINEWING SAS's expertise in the PRC Enterprise Bankruptcy Law

Upcoming events – FIS Insight workshops



Thumbnails – hidden treasure!

By Matthew Chu, Senior Manager and Kenneth Lam, Assistant Manager

Forensic examiners always seek the smallest pieces of evidence to build a case; whereas the function of thumbnails in Windows has proved to be successful for different and sometimes difficult investigations. This is especially true when most programs generate thumbnails (or thumbcaches) of the original images that are unknowingly stored on the computer even if the original picture(s) have been deleted.

Generally speaking, the thumbnail function allows users to be able to quickly preview pictures or the first

page of documents without having to open them with their associated application.

For earlier versions of Windows, e.g. Windows XP, it stores thumbnails in a file named *thumbs.db*. However, Windows Vista, Windows 7 and Windows 8 bring enhancements that centralise the thumbnail cache under the files: *thumbcache_idx.db*, *thumbcache_1024.db*, *thumbcache_256.db*, *thumbcache_96.db* and *thumbcache_32.db*, collectively “thumbnail database” to automatically store the cached thumbnails.

Benefits of thumbnails

In Windows, thumbnails of pictures and sometimes documents (such as Word, Excel and PDF, etc.) are generated, and maybe cached when the folder containing these files are being accessed.

While thumbnails speed up the viewing process for users, forensic examiners take advantage by examining these cached thumbnails and can potentially identify deleted files that may have previously existed on a suspect’s computer; and in some cases, files previously viewed from an external device such as a USB storage device. These are the pieces of evidence for forensic examiners to retrieve and prove that a file has previously been existed or viewed on the suspect’s computer.

The word "thumbnail" is a reference to the human thumbnail and alludes towards the small size of the image or picture, comparable to the size of the human thumbnail (source: <http://en.wikipedia.org/wiki/Thumbnail>)

A step towards the right direction

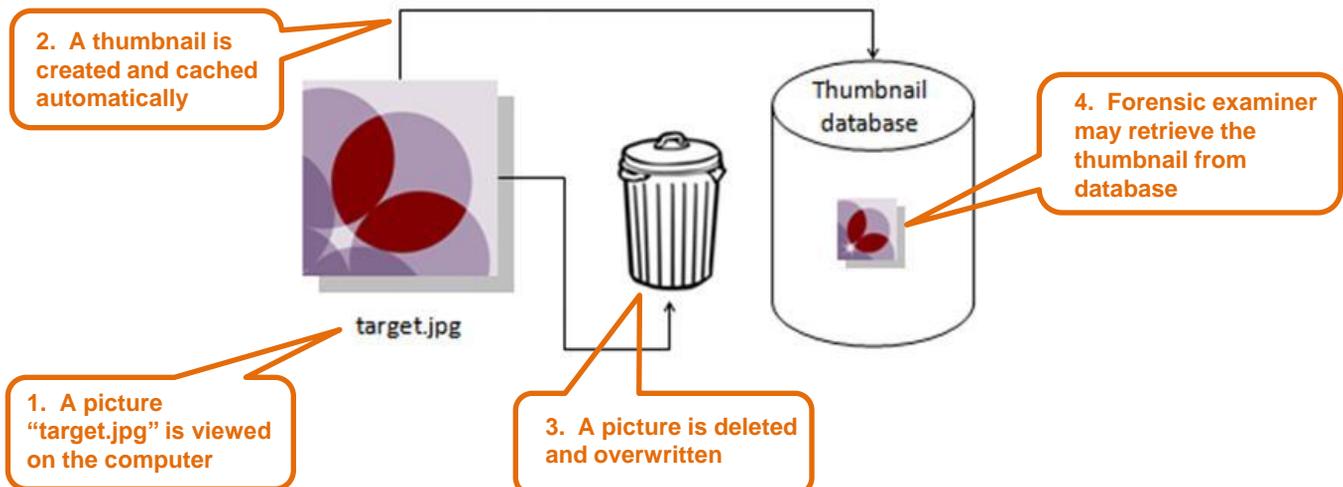
In earlier versions of Windows, the thumbnails (or the *thumbs.db*) are stored together within the same folder as the picture(s) or document(s), and that could be intentionally deleted; or removed if it was stored on a USB storage device. However, in Windows 7 for

example, it first centralises the cached pictures and documents and then stores them, into different sizes from a small picture (32 points) up to a big picture (1024 points), in the thumbnail database which allows the forensic examiner to examine these potential evidence. This provides forensic examiners a few more sources when retrieving electronic evidence.

Summary

With improvements of functionality and how thumbnails are being managed via recent releases of Windows, forensic examiners can retrieve and extract potential discriminating evidence to help in proving that certain files have previously existed and/or been accessed through a suspect's computer, although the original files might have been intentionally deleted or removed. With bigger sized (or higher resolution) thumbnails, thumbnail examination could help to make or break a case!

A simple illustration, shows how a forensic examiner can locate thumbnails.



Personal Bankruptcy - Part Two

By Pauline Au, *Manager*

Introduction

In Part 1 of the same series, we outlined the statutory framework for the automatic discharge of bankrupts and grounds for objection before the end of the 4 years bankruptcy period (or 5 years for repeated bankrupts). In this article, we will illustrate through a war story the practical tools for trustees when a bankrupt is not cooperative, or even leaves Hong Kong without informing his trustees. Furthermore, we will discuss possible “for” and “against” arguments in an application for the objection of an automatic discharge under Section 30A(10)(a) of the Bankruptcy Ordinance (“BO”).

War Story of Mr X, a bankrupt

Background

A creditor’s bankruptcy petition was presented against Mr X, who is not a permanent resident in Hong Kong. Before making a bankruptcy order against him, Mr X left Hong Kong. Due to the lack

of co-operation from Mr X in the bankruptcy administration, three court applications were taken by the trustees in bankruptcy (the “Trustees”) against Mr X.

Application 1: Application for objecting Mr X’s automatic discharge

Subsequent to the making of bankruptcy order in November 2010, the Trustees, appointed in March 2007, wrote to Mr X’s last known overseas addresses requesting for the provision of details of his assets and liabilities (i.e. completion of the statement of affairs and an annual statement of earnings).

Despite repeated requests, Mr X was not cooperative with the Trustees or provided any information in relation to his financial affairs. Apparently, he was in breach of his obligations under the BO. In view of the expiration of the 4-year bankruptcy period, under Section 30A of the BO, the Trustees submitted an application in late 2010 objecting to the discharge of Mr X under the grounds that, inter alia,

“the bankrupt has failed to co-operate in the administration of his estate” and “the conduct of the bankrupt, either in respect of the period before or the period after the commencement of the bankruptcy has been unsatisfactory.”

Before a substantial hearing was heard for this application, the Trustees took out another two applications against Mr X. We will come back and discuss in later part of this article an important issue relating to this objection application.

Application 2: Application for court examination

During the administration of the estate, it was noted that Mr X was an experienced businessman and professional investor prior to the commencement of his bankruptcy.





His refusal to submit the statement of affairs, despite repeated requests from the Trustees, may suggest that he was mindful to disclose his assets and also, he was concerned of the consequences for filing an incorrect statement of affairs. The Trustees believed that Mr X might in fact, have means to repay debts owed to his creditors.

In the circumstances, due completion of his statement of affairs and private examination of Mr X became important and necessary. In May 2011, under Section 29 of the BO, the Trustees applied for a court examination against Mr X. The summons for examination, together with relevant court documents, was served to the last known overseas addresses of the Bankrupt and in July 2011, an order for examination was granted by the court.

Upon obtaining further leave from the court, the Trustees served the

order for examination by substituted service and the examination hearing was then fixed in November 2011. However, Mr X failed to attend the hearing and was adjourned to a date to be fixed.

Application 3: Application for prohibition order (and warrant of arrest)

While failing to get Mr X to attend the examination hearing, the Trustees had to use other means to obtain information from Mr X. Based on the travelling records of Mr X provided by the Immigration Department, it was noted that Mr X travelled frequently to PRC via Hong Kong, but did not bother to inform the Trustees of his itinerary. The Trustees believed that Mr X had deliberately attempted to avoid his examination and delay the bankruptcy proceedings against him.

Another court application was then made by the Trustees for a prohibition order and a warrant of arrest, under Section 21B of the High Court Ordinance and Section 27 of the BO respectively. The

order prohibiting Mr X from leaving Hong Kong and the warrant of arrest were granted by the court in April 2012.

A week after the granting of the prohibition order and the warrant of arrest, Mr X was arrested when he passed through an immigration check point and he was then brought to the court within 24 hours. By giving an undertaking for his attendance to a court hearing for the examination scheduled at the end of April 2012, Mr X was discharged from the prohibition order and warrant of arrest accordingly.

Application for objecting Mr X's automatic discharge

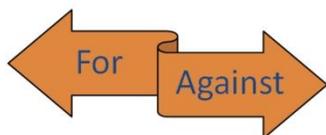
Now, let's go back to the application for objecting Mr X's automatic discharge. During the evidence submission stage, an issue on constitutionality of Section 30A(10)(a) of the BO was raised. Pending the court's raised. Pending the court's decision on this constitutionality issue, the court examination of Mr X (under Application 2 of the Trustees) was adjourned sine die.



What does the legislation say?

The legislation states that if a bankrupt has, before the commencement of the bankruptcy, left Hong Kong and has not returned thereafter, the relevant period that a bankrupt is discharged from bankruptcy by the expiration of the relevant period, *shall not commence to run until such time as he returns to Hong Kong and notifies the trustee of his return.*

In this case, Mr X left Hong Kong before the making of bankruptcy order in November 2006. He admitted that he had received some legal and court documents apparently relating to the debts owed to his creditors before he left Hong Kong, but he did not read those documents at all. Whether this Section 30A(10)(a) applies to Mr X, and whether this piece of legislation is against constitution is currently unknown.



Possible arguments for the legislation are:

- it is an important provision enacted to ensure that a bankrupt would stay in Hong Kong and within the “radar” of the trustee at the early stage of his bankruptcy; and which is intended to discourage absconding;
- the presence of a bankrupt in Hong Kong, in particular at the commencement of his bankruptcy, is necessary and appropriate for the effective operation of the statutory scheme of bankruptcy; and
- it protects the rights of the creditors and maintains commercial morality.

Possible arguments against the legislation are:

- reasons of innocence or negligence - the bankrupt may not be “aware of” his bankruptcy when he leaves Hong Kong;
- the legislation applies indiscriminately to “all” situations - it is imposed whatever the circumstances, irrespective of whether it has occasioned any prejudice to the administration of the estate and even where the bankrupt's co-operation is not required; and

- the sweeping application of the legislation means that there is no discretion vested in the court to disapply the legislation or to mitigate its consequences, however meritorious or deserving the circumstances.

It remains to be seen what the outcome is from the discussion of this constitutionality issue.

Conclusion

No doubt that the court's comments and decision is important to clarify the meaning of “bankruptcy period” and on what basis or principles that the trustees in future, may object to the discharge of bankrupts who have ignored their statutory duties and obligations under the law; and left Hong Kong before (and even after) the making of the bankruptcy order.

We believe substantial arguments, and maybe a court decision, on this issue will be available later this year; and we shall update the readers the outcome in our coming eBulletin.

Things you need to know when managing your China investments

By June Siu, Vice President

Many foreign acquirers or investors of Chinese enterprises would expect that most of the challenges are over after completing their M&A deals. The reality is that they are still subject to various hidden risks during the investment stage, which are quite often overlooked especially when their businesses are performing well.

What are the major areas that investors need to pay special attention to in respect of their investments in China?

Risks of frauds and misstatements

Frauds usually involve misappropriation of company assets/funds, while misstatements usually involve earnings or profit inflation. Typical examples include capitalisation of expenses, or sales and related accounts receivable recorded in premature periods. Research indicated that there is an increasing likelihood of frauds and misstatements when corporations are feeling greater

financial pressure in the downturn, or when they intend to sell their businesses.

Acquirers may need to pay a high price if they fail to identify accounting misconducts in the acquired company. In January this year, the US equipment maker, Caterpillar Inc. discovered an accounting misconduct within a recently acquired Chinese company, ERA Mining Machinery Ltd (a company previously listed on the Stock Exchange of Hong Kong which subsequently delisted in October 2012). As a result, Caterpillar announced that it will have to write off “non-cash goodwill impairment charge” of US\$580 million out of the US\$700 million it paid for the acquisition of ERA.

Investors may also suffer huge loss if they are unable to detect financial abnormalities. Last year, Boshiwa International (1698.HK, trading suspended since March 2012), a Chinese children’s wear company, reported an operating cash outflow of over RMB900 million in its 2011 interim results, albeit a net earnings

of RMB130 million for the period. Share price of Boshiwa subsequently plunged by over 40% after the resignation of its ex-auditor who casted doubt on the existence and commercial substance of certain business transactions. Trading of the stock was then suspended. Currently, the company is still undergoing an investigation by a professional firm on the matters raised by the ex-auditor.

Prevention is always better than cure. To reduce such risks, investors should closely monitor the financial performance of their investee companies, and stay alert of any warning signals including:

- When earnings increase, cash flows from operations reduce.



- Earnings increase while investing cash outflows / capital expenditure reduce.
- Significant increase in receivables without corresponding increase in earnings and cash balances.
- Existence of abnormal transactions, e.g. fund flows or financing arrangements with related parties, large non-cash transactions.
- Issue of qualified audit opinions, or resignation of auditors.

The above are just some of the common warning signals. As today's fraud can take many forms and is sometimes complex, investors should consider bringing in independent experts to undertake detailed business review or investigation when necessary.

Cash flows and working capital management

In practice, a good cash flow forecast can be an effective tool to

assist management to respond to adverse changes quickly. Such forecast also helps minimise the risk of corporate failure as a result of cash flow problems. In reality, many Chinese local enterprises, especially small businesses, do not have a good practice of preparing cash flow forecast on a regular basis, but rather on "when-needed" basis. When market turns or a major debtor defaults, these companies' liquidity position could be severely affected.

A few points to note when preparing and reviewing cash flow forecasts:

- Keep abreast of the latest market developments. When the market situation becomes more volatile, focus on accurate, shorter-term or rolling forecasts, and revisit forecast assumptions more often (say, bi-weekly or monthly).
- "Stress-test" your investee company's working capital regularly, and make sure that there is sufficient liquidity to manage short-term financing and significant commitment needs.

- Review the existing trading terms with customers and creditors. Make sure that they are effectively managed to cater for the company's cash flow needs.
- In addition to managing debtors, inventories and creditors, review other areas for possible cash savings, such as the existing tax and rental arrangements.

Shareholders' disputes

While the incorporation of proper "reps and warranties" in investment agreements can protect investor's rights to some extent, the legal enforceability of agreements in China is sometimes questionable. Furthermore, many Chinese owners are not willing to hand over their management control after the sale of their majority stake, therefore investors may not effectively control the company's operations in the event of shareholders' disputes. The recent conflict between the founder of NVC Lighting Holding (HK.2222) and its foreign partners is a classic example, although much extreme.

The conflict has led to a strike and business suspension in an attempt to bring the founder back to the board of directors.

Very often, the goals of foreign and local partners in joint ventures might be different, e.g. foreign partner looks for market expansion and quick profit return, while the local partner looks for technology advancement. To reduce the chance of disputes, investors should not only carry out thorough background checks on owners and managers before the deal, but also need to look for, and work with the local partners towards common business goals during the investment stage.

The “exit” challenges

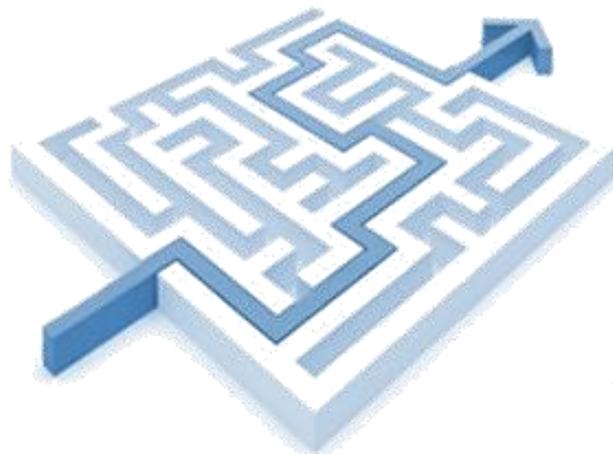
Many investors will consider an “exit” of their investment several years after making their initial investment in a company.

Investors should be reminded that in China, holding a controlling stake on paper does not guarantee investors the right to sell as they wish. When doing deals in China, investors also need to carefully manage the “relationship” and “communication” with their local partners. Earlier in this year, Actis, a British private equity firm and controlling shareholder of the popular mainland hotpot chain, Xiabu Xiabu Catering Management encountered great pressure from the Chinese founding family when it tried to sell its stake to its preferred buyers, who offered more attractive prices than other bidders. The potential sale was once

hindered by the local management team, who refused to open the financial books for buyer’s due diligence.

Conclusion

No one has a “crystal ball” and can accurately foresee all hidden risks associated with its investments. To reduce the chance of investment failure and minimise the risk, investors should always take precautionary measures, such as regularly monitoring their investments and staying alert of any unusual warning signs.



Knowledge

Recovery and Reorganisation

Three Musketeers in insolvency administrations: Provisional liquidators, Liquidators and Receivers

Do you know these three musketeers and some of the differences between them? This article gives you a brief introduction of these musketeers, their roles, duties and powers in company's insolvency administrations.

Provisional Liquidators (PLs)

PLs could be appointed in a creditors voluntary liquidation (S.228A of Companies Ordinance (Cap.32)(CO)) or compulsory liquidation. There is no specific qualification for the appointment of PLs except for the appointment under S.228A where the appointees must be a solicitor or professional accountant under the Professional Accountants Ordinance (Cap.50). PLs usually have limited powers as given by a court order. Key responsibilities of PLs are preserving assets of the

company, including but not limited to carrying on businesses, preparing cash flow forecasts, reporting to court and obtaining offer from potential buyer regarding future selling of assets. PLs generally do not have the power of sale unless ordered by the court.

Liquidators (Ls)

Under normal circumstances, Ls are appointed at the first creditors' meeting. In a compulsory winding-up, a court order for appointment is required. Since the PLs (if any) have preserved assets and maintained status quo for the company, Ls may decide to realise the assets in good faith and exercise powers. Amongst other duties, Ls are also bounded to carrying out statutory investigations into the company's affairs and directors' conduct in order to safeguard the interest of all creditors and contributories.

Receivers & Managers (Receivers)

Receivers are usually appointed by debenture holders according to the terms of a debenture or loan document. Receivers, being an agent of the company, are usually appointed to preserve and realise the charged assets and repay the secured debts of the debenture holders. Powers of Receivers are governed by the debenture and/or appointment document, which may include collecting, realising and selling of the charged assets. Upon the appointment of Receivers, directors' powers have ceased except to assist Receivers to understand the company's previous affairs / transactions. Receivers have no duty to carrying on the business of the company unless it is justified that trading-on would generate profits. Otherwise, Receivers may be personal liable for the trading losses. Company in receivership does not mean that it has been wound-up. However, in most cases, unsecured creditors would petition to the court for a company's winding-up subsequent to the appointment of Receivers.

Differences between PLs, Ls and Receivers

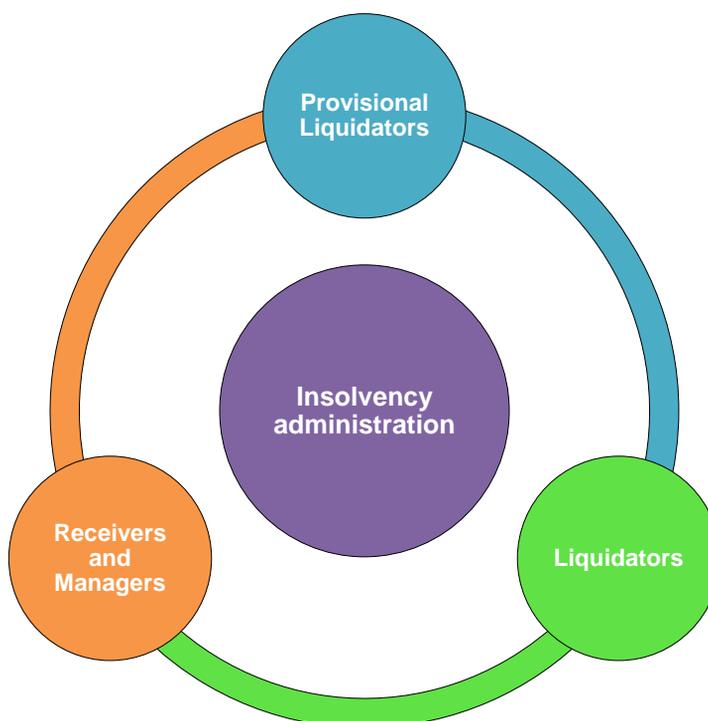
A company in liquidation could have PLs and followed by Ls when a winding-up order is made.

However, Receivers are usually appointed by debenture holder prior to the time when PLs or Ls are appointed.

Companies appointed Receivers do not mean the company is insolvent

but an insolvent company may have Receivers and Ls (or PLs) co-exist. In most cases, secured creditors, usually banks, would appoint Receivers but **not** putting the Company into liquidation, for the purpose of realising the charged assets on a trading-on basis in priority to all other unsecured creditors. Receivers under the CO are required to pay preferential debts, but their

primary duty are acting in the interest of **secured** creditors while liquidators are acting in the interest of **all** creditors. Liquidators have extensive powers of investigation, which are not available to Receivers. Receivers are usually indemnified by company's assets if validly appointed but they become the principal if recovery actions are not endorsed by the liquidators.



SHINEWING SAS's expertise in the PRC Enterprise Bankruptcy Law

Alan Tang, the head of SAS, was invited to speak at more than six local and international forums to share his views and expertise, from an experienced insolvency practitioner's perspective, in PRC enterprises' restructuring and insolvency related matters, in 2012. These forums included a training of some 200 senior PRC bankruptcy judges in a World Bank sponsored training program at the Beidahe National Judges College near Beijing, INSOL International Beijing PRC seminar, the fourth annual conference for the East Asian Association of Insolvency & Restructuring, the fifth China Bankruptcy Law Forum organised by the Supreme People's Court of the PRC, Seminar on corporate restructuring and precautions for bankruptcy organised by Ningbo Financial Association and the Restructuring and Insolvency Faculty lunch seminar organised by Hong Kong Institute of Certified Public Accountants.

In total, over 1,500 participants, mostly are government officials, PRC senior bankruptcy judges, bankers, investors, lawyers, academics and insolvency practitioners joined these forums. Alan's participation in these events was also reported in the newsletter of SHINEWING Beijing issued in January 2013 and Ningbo Finance Magazine issued in February 2013.

Apart from the above conferences, Alan is also one of the co-authors of

a technical paper on "Confronting Practical Challenges and Pursuing Creative Solutions" which was issued in July 2012 under the 24th technical paper of the INSOL Technical Papers Series.

Under the leadership of Alan, our SAS team is dedicated to promote the perfection of PRC Enterprise Bankruptcy Law and to assist our clients in resolving the practical restructuring and insolvency issues they encounter.



Upcoming events

FIS Insight workshops

Forensics & Investigation Services

Disputes need to be resolved efficiently. They usually involve disagreement amongst shareholders or family members, breaches of contracts, suspected fraud, employee misconduct, litigation and asset tracing.

SHINEWING's forensic accounting and investigation experts act professionally and independently to meet with clients' needs.

Details of the workshops and registration arrangements will be announced under separate emails.

Topics of the workshops are:

Digital Forensics and beyond – 6 March 2013

- What are digital investigations?
- Digital evidence awareness and related challenges
- The approach of a computer forensics examiner
- Modus operandi and motives – suspect profiling
- Evolution of computer forensics and crime

Building up your digital evidence – e-discovery 20 March 2013

- Digital evidence and computers
- A sea full of artifacts – types of evidence
- The Good, the Bad and the Ugly – protect your information
- Case study – war stories on cases with digital evidence

Hands-on with Intella... (TBC)

- Intella as an investigative tool
- The players – team alpha, beta and bravo
- Concepts and tagging – finding the needle...
- Case study – examine, tag and report



Feedback from readers is essential to our success. We welcome and value your comments or suggestions. Feel free to contact us for any questions as well.