

CHAPTER 5

THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION

GENERAL REVENUE ACCOUNT

GOVERNMENT DEPARTMENT

Official Receiver's Office

Services provided by the Official Receiver's Office

**Audit Commission
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SERVICES PROVIDED BY THE OFFICIAL RECEIVER'S OFFICE

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SERVICES PROVIDED BY THE OFFICIAL RECEIVER'S OFFICE

Summary and key findings

A. **Introduction.** The main functions of the Official Receiver's Office (ORO) are to provide insolvency management services and to monitor the performance of private insolvency practitioners (PIP) in compulsory liquidations and in bankruptcies. As at 1 November 1999, the ORO had an approved establishment of 266 staff with an estimated expenditure of \$145.4 million in 1999-2000. Audit has recently conducted a review of the services provided by the ORO and found that there is room for improvement in a number of areas (paras. 1.1, 1.4 and 1.5).

B. **Monitoring of staff workload.** The ORO has not established standards on the productivity of the Insolvency Officers (IOs). Audit's analysis revealed that there was a wide variation in the workload of the IOs of the same rank. The wide variation in the workload suggests that there might have been undue delay in the completion of some cases by the IOs (paras. 2.2 to 2.4).

C. The ORO has not set a time limit for its in-house teams to complete an insolvency case. Audit noted that less than 5% of the cases handled by the ORO were completed within a year. About 22% of the cases took more than three years to be completed. By comparison, Audit noted that of the 181 insolvency cases handled by PIP, 41.4% were on average completed within 15 months. Audit noted that the requirement to complete time record sheets as stated in the technical circulars issued by the ORO had not been followed by the case IOs (paras. 2.12, 2.15 and 2.21).

D. **Ascertaining and realisation of assets of insolvent estates.** The ORO has not kept statistics on the number of doubtful cases relating to the under-reporting of assets. It is difficult to ascertain whether appropriate follow-up action has been taken on the identified irregularities (para. 3.5).

E. From June 1997 to May 1999, the ORO referred 330 cases with book debts of \$2,967 million to a debt collection agent. Up to September 1999, only \$3.14 million (or 0.1% of the debts) was recovered. Audit noted that the debtors made payments direct to the debt collection agent and book debts were simply written off as recommended by the debt collection agent without further checks. Audit considers that there is a need for the ORO to strengthen its control over the collection of debts (paras. 3.16, 3.18 and 3.19).

F. **Distribution of realised assets and law enforcement.** As at 31 July 1999, \$4,523 million of the estates of insolvent companies and \$157 million of the estates of bankrupts were placed on bank deposits. \$2,378 million of the estates of insolvent companies had been held for more than one year. An audit test check indicated that the ORO had not taken positive action to distribute dividends to the creditors as soon as practicable. Audit also noted that the percentage of the number of prosecutions

and disqualification proceedings to the number of winding-up orders and bankruptcy orders had dropped significantly in 1998-99 (paras. 4.4 to 4.6 and 4.12).

G. **Performance measurement and service delivery.** The ORO has managed to meet most of the pledged service standards. However, the ORO has not revised the performance targets to reflect the present-day circumstances. Moreover, the existing performance indicators and targets do not refer to the time the ORO is expected to complete the main processes of the insolvency work. Audit notes that the ORO is currently working on the proposal of allowing the public to have on-line access to its computerised Management Information System. However, the ORO has not conducted a survey to assess users' requirements (paras. 5.3, 5.4 and 5.6).

H. **Appointment of PIP to handle insolvency cases.** Audit notes that the appointment of PIP as liquidators (for insolvency cases with realisable assets exceeding \$200,000) and as agents for the ORO (for cases with realisable assets not exceeding \$200,000) is on a roster basis. However, there is no assessment as to whether the most competitive fee is offered for the services (paras. 6.2 to 6.4 and 6.6).

I. **Monitoring of performance of PIP and their fees.** Audit notes that the ORO has not taken adequate and effective action to monitor the performance of and fees charged by PIP (paras. 7.5 and 7.21).

J. **Fees charged by the ORO.** Audit notes that the ORO has not established a long-term cost-recovery strategy to recover its cost of administering insolvency cases. The major revenue items of the ORO are derived from fees based on a percentage of assets realised and distributed from an insolvent estate. However, this method of charging fees is inequitable because the fees charged are not related to the time spent and the costs of administering each case. Moreover, this method provides no assurance that the fee received can achieve the target cost-recovery rate. For the period June 1992 to March 1999, the total operating deficit of the ORO amounted to \$300 million. Under the existing legislation, except for those cases where the Official Receiver is the provisional liquidator, the ORO cannot charge fees on a full time-cost recovery basis. Audit estimated that \$103 million of this deficit could have been recovered from the estates with available assets had amendments to the present legislation been made to enable the charging of fees based on the costs of insolvency administration. Audit also noted that there were incidents where the ORO had not paid due regard to economy in the course of its administration of the insolvent estates (paras. 8.8 to 8.10, 8.15 and 8.21).

K. **Audit recommendations.** Audit has made the following major recommendations:

— the Official Receiver should:

- (i) establish performance measures (e.g. manpower resource budgets) for assessing the productivity of individual IOs and for determining the number of insolvency cases to be handled by them (first inset of para. 2.7);

- (ii) for the purposes of monitoring of performance and billing of fees, promptly set up a time-recording system to record the manpower resource budgets and the actual time spent by ORO staff to complete an insolvency case (second inset of para. 2.23);
 - (iii) ensure that any write-off of book debts recommended by the debt collection agent is fully justified and that all debts collected by the debt collection agent are promptly remitted to the ORO (sub-paras. (c) and (d) of para. 3.23);
 - (iv) closely monitor the progress of the distribution of realised assets in future and take prompt action to ensure that surplus funds of insolvent estates are distributed to creditors and shareholders at the earliest opportunity (second inset of para. 4.8);
 - (v) maintain records of the resources used on the ORO's law enforcement activities and set performance standards for such activities (first and second insets of para. 4.15);
 - (vi) conduct a review to ascertain whether improvements can be made to the existing performance pledges of the ORO (fourth inset of para. 5.7);
 - (vii) critically consider whether it is practicable and cost-effective to replace the existing roster system of appointing PIP with a tender system of appointment based on competitive bidding (second inset of para. 6.7);
 - (viii) closely monitor and follow up any outstanding items at every stage of the liquidation process to ensure that there is no undue delay on the part of PIP as liquidators, particularly in the distribution of dividends (second inset of para. 7.7);
 - (ix) expedite the process of issuing guidelines to PIP as liquidators on the billing of time-cost fees and other liquidation fees (first inset of para. 7.25); and
 - (x) issue guidelines for ORO staff to economise on the use of the estates' funds in administering insolvency matters and introduce proper procedures for the approval of payments (first inset of para. 8.27); and
- the Official Receiver should, in consultation with the Secretary for Financial Services and the Secretary for the Treasury, critically consider the feasibility of charging insolvency fees on the basis of the full cost of insolvency administration (second inset of para. 8.17).

L. Response from the Administration. The Administration agrees with most of the audit recommendations.

PART 1: INTRODUCTION

Services provided by the Official Receiver's Office

1.1 On 1 June 1992, the Official Receiver's Office (ORO) was established to replace the Insolvency Division of the then Registrar General's Department. The ORO has the following main functions:

- to provide insolvency (Note 1) management services when the Official Receiver is appointed by court and creditors to act as trustee under the Bankruptcy Ordinance (Cap. 6) or liquidator under the winding-up provisions of the Companies Ordinance (Cap. 32). The Official Receiver's role is to realise the assets of insolvent companies and bankrupts, adjudicate creditors' claims and distribute dividends to preferential and ordinary creditors;
- to provide a public service by acting as trustee or liquidator of last resort in cases where the assets of an insolvent estate do not cover the costs of administration;
- to investigate into the conduct of debtors, directors and officers of insolvent companies and the causes of business failures;
- to prosecute insolvency offenders; and
- to monitor the performance of private insolvency practitioners (PIP), who act as liquidators in compulsory liquidations and as trustees in bankruptcies, invest the funds realised by them, audit their accounts and investigate complaints against them.

1.2 The law discharges the bankrupts and the insolvent companies of all debts under certain conditions, and protects those with debts from harassment by creditors. It also enables creditors, after proving their claims, to benefit from the distribution of funds from the sale of assets of the bankrupts or insolvent companies.

Note 1: *Insolvency is a situation where a person or a partnership cannot pay money owed, or a company is unable to pay its debts. A creditor, or a group of creditors acting together, may institute bankruptcy proceedings in the case of an individual or a partnership. Similar proceedings against a company are known as a winding up or liquidation of the company. A person may initiate his own bankruptcy and a company may elect voluntary liquidation.*

1.3 In 1998-99, there were 1,016 petitions for company liquidation and 1,827 petitions for individual bankruptcies. The court made 763 winding-up orders and 1,179 bankruptcy orders. As at 30 November 1999, there were 2,527 outstanding winding-up cases and 4,488 outstanding bankruptcy cases.

1.4 As at 1 November 1999, the ORO, with an approved establishment of 266 staff, was divided into the Case Management Division (CMD), the two Legal Services Divisions, the Financial Services Division (FSD) and the Departmental Administration Division. The organisation chart of the ORO as at 1 November 1999 is at Appendix A. The estimated expenditure of the ORO in 1999-2000 is \$145.4 million.

Audit review

1.5 Audit has recently conducted a review of the economy, efficiency and effectiveness of the various services provided by the ORO. The results indicate that there is room for improvement in a number of areas.

PART 2: MONITORING OF STAFF WORKLOAD

Allocation of insolvency cases to Insolvency Officers

2.1 The CMD, headed by the Assistant Official Receiver (Case Management), is responsible for administering all bankruptcy and winding-up cases. As at 1 November 1999, the CMD had an approved establishment of 64 Insolvency Officers (IOs) and 56 clerical staff, and was divided into eight case management teams. Each team is headed by a Chief Insolvency Officer (CIO). Insolvency cases are allocated to the IOs in the following manner:

- bankruptcy and winding-up cases are equally allocated to the eight case management teams; and
- the CIO of each team further allocates insolvency cases to IOs. Complicated cases are allocated to more experienced officers (Note 2).

Audit observations on allocation of insolvency cases

2.2 Audit noted that the ORO had not established standards on the productivity of the IOs (e.g. the number of insolvency cases that should be completed by an IO within a certain period, or the minimum number of active cases that should be handled by him/her at any time). The ORO essentially relied on the supervision of the CIOs, Senior IOs and IOs I to ensure that all the IOs had been fully and gainfully employed in handling insolvency cases.

2.3 Audit's analysis revealed that there was a wide variation in the workload of the IOs of the same rank. A snapshot of the workload of the IOs as at the end of July 1999 (e.g. the number of cases handled by each IO II ranged from 47 to 95) is shown in Table 1 below.

Note 2: *The IO grade officers consist of CIOs, Senior IOs, IOs I and IOs II. In general, officers of the more senior ranks handle more complicated cases and have to supervise the work of junior officers.*

Table 1

Distribution of workload of the IOs

Number of cases	Number of CIOs	Number of Senior IOs	Number of IOs I	Number of IOs II	Total number of staff
43 – 50	2	–	–	1	3
51 – 60	3	–	1	2	6
61 – 70	2	3	2	5	12
71 – 80	1	3	6	6	16
81 – 90	–	1	4	15	20
91 – 97	–	–	3	3	6
Total	<u>8</u>	<u>7</u>	<u>16</u>	<u>32</u>	<u>63</u>

Source: Audit's analysis of ORO's records

2.4 In Audit's view, the wide variation in the workload of the IOs is a matter of concern because most of the cases handled by all the IOs were small cases (i.e. with realisable assets not exceeding \$50,000) and each case should have required less than 40 man-hours to complete. Such a wide variation in the workload suggests that there might have been undue delay in the completion of some cases by the IOs, resulting in a large backlog of active cases in their hands.

2.5 Apart from obtaining general assurances from the field-supervising officers about the standard of work, there is no objective yardstick or performance measure to enable the Official Receiver to deal with the unsatisfactory situation mentioned in paragraph 2.4 above. Based on the statistics on the number of active cases handled by individual IOs, the CIO of each case management team cannot assess whether an IO has an appropriate caseload. This is because the statistics do not reflect the actual quantity of insolvency work and the extent of completion of the different processes of work (see paragraph 2.11 below).

2.6 In Audit's view, there is a need for the Official Receiver to consider ways to monitor the insolvency work of all the IOs in a more objective manner with a view to ensuring that they are fully and gainfully employed in handling insolvency cases. This can be achieved by the introduction of manpower resource budgets for different categories of insolvency cases (e.g. the IOs are expected to use less than 40 man-hours for insolvency cases with realisable assets not exceeding \$50,000). Audit notes that the ORO is allowed to engage PIP to assist the IOs in the handling of insolvency cases. For this purpose, the ORO has an annual provision of

\$21 million for 400 company liquidation cases under the Panel B Scheme (see paragraph 6.3 below). After the introduction of manpower resource budgets, the productivity gain of the case management teams can be used to handle more cases in-house. This will reduce the number of appointments of PIP and the associated government expenditure.

Audit recommendations on allocation of insolvency cases

2.7 Audit has *recommended* that the Official Receiver should:

- establish performance measures (e.g. manpower resource budgets) for assessing the productivity of individual IOs and for determining the number of insolvency cases to be handled by them;
- set up a monitoring system (e.g. a time-recording system to record the staff resources used on each insolvency case) for reviewing regularly the productivity of the case management teams; and
- ensure that all the IOs are fully and gainfully employed in insolvency case work before PIP are engaged as agents to handle insolvency cases under the Panel B Scheme (see paragraph 6.3 below).

Response from the Administration

2.8 The **Secretary for Financial Services** has said that this audit review is the first of its kind since the establishment of the ORO as a government department. He is most grateful to Audit for this comprehensive review and the detailed findings on the services provided by different sections in the ORO, especially those of the CMD and the FSD.

2.9 The **Secretary for the Treasury** has said that she welcomes the audit recommendations which will surely help improve the cost-effectiveness of the ORO. She will take into account the audit observations in assessing the ORO's overall resource requirements to ensure that the ORO is providing a cost-effective service to the public. She has also said that resources have been allocated to the Financial Services Bureau to undertake a consultancy study to review the future role and functions of the ORO. The review will likely be able to address a number of the audit concerns.

2.10 The **Official Receiver** has said that he agrees with the audit recommendations on the allocation of insolvency cases. He has also said that:

- the variation in the workload distribution was due in part to less cases being allocated to particular officers who had been given special assignments;

- there are some management tools to check the performance of the IOs. The Consolidated Monthly Performance Report and the IO Case Allocation List show key stages of cases handled by individual IOs. The standard proforma to put a case on Small Case Programme also serves as a case review by the supervising IOs; and
- with the enhanced Official Receiver's Management Information System which will be operative after mid-March 2000, a Target Completion Report for straightforward summary cases will be introduced.

Time taken to complete an insolvency case

2.11 For each insolvency case, the ORO has to complete the following main processes of the insolvency work:

- (a) gazetting bankruptcy and liquidation notices and convening creditors' meetings;
- (b) ascertaining and realising assets and examining statements of affairs submitted by bankrupts and insolvent companies;
- (c) investigating the affairs of bankrupts or insolvent companies and the conduct of bankrupts and directors of insolvent companies;
- (d) adjudicating claims submitted by creditors;
- (e) distributing proceeds realised from assets owned by bankrupts and insolvent companies; and
- (f) releasing liquidators/trustees and discharging bankrupts.

2.12 According to the guidelines issued by the ORO to PIP in April 1999, PIP are expected to complete an insolvency case, with realisable assets not exceeding \$200,000 and without complexity, within one year of their appointment. However, the ORO has not set a time limit for its in-house teams to complete an insolvency case.

Audit observations on time taken to complete an insolvency case

2.13 The ORO measures the performance of the IOs by referring to the number of debts pursued, the number of claims adjudicated and the number of cases completed. However, these performance measures do not take into account the time taken to complete the various main processes of insolvency work (e.g. realisation of assets, recovery of book debt and payment of dividends). In order to boost the number of completed cases, there is a tendency for the ORO staff to complete the less complicated cases first. As a result, the time taken to deal with complicated cases may be unduly long.

2.14 Table 2 below shows the time taken by the ORO staff to complete insolvency cases with realisable assets not exceeding \$200,000 and with winding-up orders issued during the period June 1992 (when the ORO was established) to March 1999.

Table 2

**Time taken to complete insolvency cases with realisable assets
not exceeding \$200,000 and with winding-up orders issued
during the period June 1992 to March 1999**

Time taken to complete cases (Years)	Number of cases	Percentage
1 year or less	59	4.8%
Over 1 year – 1.5 years	210	16.9%
Over 1.5 years – 2 years	338	27.3%
Over 2 years – 2.5 years	211	17.0%
Over 2.5 years – 3 years	151	12.2%
Over 3 years – 3.5 years	106	8.6%)
Over 3.5 years – 4 years	72	5.8%)
Over 4 years – 4.5 years	44	3.6%) 21.8%
Over 4.5 years – 5 years	22	1.8%)
Over 5 years	26	2.0%)
Total	<u>1,239</u>	<u>100.0%</u>

Source: Audit's analysis of ORO's records

2.15 The shaded areas in Table 2 above indicate that less than 5% of the cases handled by the ORO were completed within a year, and that about 22% of the cases took more than three years to be completed. By comparison, Audit noted that of the 181 insolvency cases handled by PIP for the period September 1997 (i.e. the commencement date of the pilot scheme to appoint PIP as agents for the ORO) to March 1999, 41.4% (75 cases) were on average completed within 15 months (i.e. by the end of October 1999).

2.16 According to the mission statement published in the ORO's 1998-99 Annual Departmental Report, the ORO is committed to protecting and realising the assets of insolvent estates, adjudicating the claims of creditors, and distributing the proceeds to preferential and ordinary creditors in an efficient manner as soon as practicable. In order to complete a case as soon as possible, the Official Receiver needs to establish realistic estimates of the expected completion time for each process of the insolvency work, and to introduce a proper supervisory review system to identify cases which cannot meet the target completion time for necessary follow-up action.

Audit recommendations on time taken to complete an insolvency case

2.17 **Audit has *recommended* that the Official Receiver should:**

- set realistic time limits for each main process of the insolvency work (see paragraph 2.11 above);
- require the IOs of case management teams to regularly report the progress of insolvency cases (e.g. completion dates of key events);
- closely monitor the progress of insolvency cases to ensure that there is no undue delay in processing them; and
- take necessary follow-up action on those cases which cannot meet the target completion time.

Response from the Administration

2.18 The **Official Receiver** has said that he agrees with the audit recommendations on the time taken to complete an insolvency case.

Keeping of time and cost records

2.19 The ORO staff do not record the costs incurred on an insolvency case. In this connection, in September 1998 the Administration advised the Legislative Council that:

- the Official Receiver did not keep statistics about the costs of insolvency cases because each insolvency case was unique;

- based on the minimum level of statutory investigation required and the standard procedures to be completed in each case, the estimated administration cost of an insolvency case with assets not exceeding \$50,000 was \$54,400. For cases with assets between \$50,000 and \$200,000, the estimated cost was about \$138,000; and
- the vast majority of cases handled by the ORO had assets less than \$50,000.

2.20 The ORO issued technical circulars requiring the IOs to record the time spent in a standard time record sheet for work done in respect of the following cases:

- insolvency cases with realisable assets not exceeding \$50,000. The keeping of time records is to facilitate the monitoring of the IOs' work; and
- insolvency cases with realisable assets exceeding \$200,000 where the Official Receiver acts as a provisional liquidator. The time records are required for charging the costs to individual cases.

However, the ORO did not require the IOs to record the time spent on insolvency cases with realisable assets greater than \$50,000 but not exceeding \$200,000.

Audit observations on keeping of time and cost records

2.21 Although the requirement to complete time record sheets is clearly stated in the technical circulars, this requirement had apparently not been followed by the case IOs as indicated by the following results of an audit test check:

- ***Insolvency cases with realisable assets not exceeding \$50,000.*** Only two cases out of 20 cases checked had a completed time record sheet; and
- ***Insolvency cases with realisable assets exceeding \$200,000.*** Only three cases out of 20 cases checked had a completed time record sheet.

2.22 **In the absence of proper time records, the Official Receiver is deprived of the essential information for assessing the performance of the IOs. Furthermore, the accuracy of the billing of fees by the ORO for its work is questionable. In Audit's view, there is a need for**

the ORO to consider extending the keeping of time records to cover all aspects of its insolvency work (Note 3).

Audit recommendations on keeping of time and cost records

2.23 Audit has *recommended* that the Official Receiver should:

- take action to ensure that the case IOs record the time spent on their insolvency work; and
- for the purposes of monitoring of performance and billing of fees, promptly set up a time-recording system to record the manpower resource budgets and the actual time spent by ORO staff to complete an insolvency case (see also the second inset of paragraph 8.14 below).

Response from the Administration

2.24 The **Official Receiver** has said that he agrees with the audit recommendations on the keeping of time and cost records. He agrees to set up an hourly time-recording system. To accord with the requirements of the court, this may necessitate the introduction of a proper computerised time-recording system. He has also said that:

- the ORO will only charge on time basis for his work as provisional liquidator in cases where the Official Receiver will not continue to act as the liquidator. For such cases, time sheets are prepared in support of Official Receiver's application to court for fees; and
- without time records, the ORO can still effectively appraise the performance of the IOs concerned through the management tools mentioned in the second and third insets of paragraph 2.10 above.

Note 3: *In this connection, it is worthy of note that the Insolvency Service of the United Kingdom records the case administration time by an electronic system of data capture and transmission. The system extends into the area of investigation work for the benchmarking of resource inputs.*

PART 3: ASCERTAINING AND REALISATION OF ASSETS OF INSOLVENT ESTATES

Ascertaining of hidden assets of insolvent estates

3.1 An important function of the ORO is to ascertain whether the bankrupts and the insolvent companies have hidden assets. Where a financial transaction takes place in favour of a particular party within certain time limits, the transaction may be reversed (Note 4). These transactions are termed voidable and the money must be repaid to the insolvent estates. Voidable transactions include:

- the gifting of property to a third party; and
- the sale of assets below market value or substantially discounted to the detriment of creditors.

3.2 The FSD of the ORO, which assists the CMD in ascertaining hidden assets of insolvent estates, is responsible for the examination of the statements of affairs submitted by bankrupts and insolvent companies. Depending on the amount of liabilities of an insolvency case, the FSD may carry out the following checks to look for voidable transactions or other irregularities:

- examination of transactions recorded in bank statements and in the land transaction database of the Land Registry; and
- detailed scrutiny of the books and records of the bankrupt or the insolvent company.

3.3 Upon the completion of examination of the statements of affairs and the supporting records, the FSD refers doubtful cases to the CMD for further action. If further investigations uncover evidence of misconduct, the ORO may lay charges in a court or refer the matter to the Department of Justice or the Hong Kong Police Force.

Audit observations on ascertaining of hidden assets

3.4 Audit noted that in the past years there had been only a small number of prosecutions of insolvency offences connected with hidden assets and voidable transactions, as shown in Table 3 below.

Note 4: *According to the Bankruptcy Ordinance and the Companies Ordinance, any undervalued transaction made or any unfair preference given up to a maximum of five years preceding the date of bankruptcy petitions and two years preceding the commencement of the winding up of the companies may be restored by the court.*

Table 3

**Insolvency offences connected with hidden assets and
voidable transactions reported by the ORO
1995-96 to 1998-99**

Year	Number of summonses issued (Note 1)	Number of notices sent (Note 2)	Total
1995-96	0	1	1
1996-97	2	3	5
1997-98	0	3	3
1998-99	0	0	0

Source: ORO's annual departmental reports

Note 1: Summonses were issued to bankrupts for failing to deliver books, concealing properties, and removing books and documents.

Note 2: Notices were sent to directors who had committed avoidance of dispositions of property after commencement of winding-up, fraudulent preference, fraudulent trading and misfeasance.

3.5 Audit noted that the ORO did not keep statistics on the number of doubtful cases referred by the FSD to the CMD for follow-up action. It is difficult to ascertain whether the case IOs of the CMD have taken appropriate follow-up action on irregularities identified by the FSD.

3.6 In Audit's view, there is scope for the ORO to put in place a more vigorous performance monitoring system to assess the effectiveness of its staff in ascertaining assets and identifying related insolvency offences. Records of the number of cases with under-reported assets or voidable transactions identified by the FSD and the follow-up actions taken by the case IOs of the CMD should be maintained. By regular reviews of these records, the management of the ORO can determine whether adequate action, including prosecution, has been taken on warranted cases. In the longer term, the ORO can also better plan the deployment of resources having regard to the incidence of irregularities found.

Audit recommendations on ascertaining of hidden assets

3.7 **Audit has *recommended* that the Official Receiver should:**

- **require officers of the FSD and the CMD to provide more management information (e.g. statistics) on the results of their review and investigation of assets reported by bankrupts and insolvent companies; and**
- **critically assess the cost-effectiveness of the work of the FSD and the CMD in ascertaining hidden assets and prosecuting related insolvency offences, with a view to allocating to these Divisions an appropriate level of resources.**

Response from the Administration

3.8 The **Official Receiver** has said that clear guidelines and more training on prosecution of insolvency offences will be provided by the Legal Services Division. He has also said that:

- the FSD provides the CMD with written comments on file setting out its findings in respect of each case. A number of irregularities may be identified by the FSD in respect of a case and written comments, seen by the Senior Treasury Accountant and/or the Assistant Official Receiver (Financial Services), are forwarded to the CMD for follow-up action; and
- a distinction should be drawn between asset collections and prosecutions when considering the question of cost-effectiveness. The question of effectiveness of the ORO is dependent on the extent to which statutory and/or professional standards/requirements need to be complied with, i.e. there must be a basic investigation into the causes of failure of the business to comply with the statutory requirements and to, at the very least, give the creditors an account of the reasons for the failure of the business.

Realisation of assets of insolvent estates

3.9 Table 4 below shows the amount of proceeds realised from different types of assets of insolvent estates in 1998-99.

Table 4**Realisation of assets of insolvent estates in 1998-99**

Description	Amount	
	(\$ million)	(Percentage)
Cash and cheques	0.81	0.7%
Bank account balances	52.71	47.6%
Refund of utility deposits	3.27	3.0%
Refund of insurance premia for termination of insurance policies	3.38	3.1%
Sale proceeds	14.18	12.8%
Recovery of book debts	17.47	15.8%
Other assets	18.89	17.0%
Dividends on investment	0.03	—
Total	<u>110.74</u>	<u>100.0%</u>

Source: ORO's records

3.10 Accountants of the FSD and solicitors of the two Legal Services Divisions assist the case IOs of the CMD in conducting investigation and in handling difficult matters.

Audit observations on realisation of assets

3.11 Audit noted that the ORO had adopted appropriate methods in the disposal of assets of insolvent estates. However, there is room for improvement in the collection of book debts of insolvent estates.

3.12 The book debt collection scheme by outside agents started in November 1994 when a solicitors firm approached the ORO and offered to take up the work of collecting the book debts of companies compulsorily wound up by the court. In June 1997, this collection function was taken up by another solicitors firm. In May 1999, the ORO appointed a professional debt collection agency to replace the solicitors firm.

3.13 Under the book debt collection scheme, book debts of winding-up cases with an estimated total value of \$20,000 or above are referred to the collection agent. A handling fee of \$3,000 per winding-up case and a recovery commission (at the rates of 23% to 28% of the realised proceeds of debts recovered) are payable to the agent.

Limited success of the book debt collection scheme

3.14 According to the ORO, the primary objective of the book debt collection scheme is to reduce the workload of the case IOs and the legal officers of the ORO. However, Audit has reservations about the cost-effectiveness of the scheme.

3.15 The recovery rates of book debts for completed cases for the years from 1994-95 to 1998-99 are shown in Table 5 below.

Table 5

**Recovery rates of book debts for completed cases
1994-95 to 1998-99**

Year	Nominal value of book debts (Note 1)	Total debts recovered (Note 2)	Recovery rate
	(\$ million)	(\$ million)	(Percentage)
	(a)	(b)	(c) = $\frac{(b)}{(a)} \times 100\%$
1994-95	809.77	128.29 (Note 3)	15.8%
1995-96	671.58	14.02	2.1%
1996-97	353.28	12.26	3.5%
1997-98	726.90	15.60	2.1%
1998-99	1,677.00	8.95	0.5%

Source: ORO's records

Note 1: This represents the total value of book debts for cases with recovery action completed during the year.

Note 2: This represents the total debts recovered for cases with recovery action completed during the year.

Note 3: This amount included \$116.9 million collected from a large winding-up case.

3.16 As indicated in Table 5 above, the recovery rate decreased from 15.8% in 1994-95 to 0.5% in 1998-99. From June 1997 to May 1999, the ORO referred 330 cases with book debts of \$2,967 million to the solicitors firm. Up to September 1999, only \$3.14 million (or 0.1% of the debts) was recovered. The fees paid to the solicitors firm amounted to \$0.72 million.

3.17 **In Audit's view, with a recovery rate of 0.1%, the performance of the solicitors firm as the ORO's debt collection agent was unsatisfactory.** Audit noted that:

- the ORO had not carried out an overall review of the performance of the debt collection agents and the cost-effectiveness of the book debt collection scheme since its inception in November 1994. The ORO did not compile statistics on the recovery rates of debts collected by its in-house staff and the collection agents;
- the ORO had not issued specific guidelines on how the case IOs would ensure that the collection agents exercise due diligence on debt recovery; and
- there was a tendency for the collection agents to suggest writing off those book debts which were difficult to collect because they were entitled to receive \$3,000 per insolvency case as a handling fee, irrespective of the outcome of their recovery action.

3.18 An audit test check of book debts collected by agents indicated that the ORO simply wrote off the book debts as recommended by the debt collection agents without checking the details or requesting the agents to provide evidence of the non-recovery. For example, in a company winding-up case, the collection agent recommended and the ORO agreed to write off a debt of \$47,085 simply because the debtor had moved out from the known address. By comparison, Audit noted that the ORO had stricter guidelines on the write-off of debts handled by its staff. For example, before write-off action is initiated for a case handled in-house, a business registration search to locate the debtors is required to be conducted.

Proceeds of debts recovered by collection agents

3.19 Audit noted that under the book debt collection scheme, the debtors made payments direct to the debt collection agent. The debt collection agent was entitled to first deduct his fees from the proceeds before remitting the balance to the ORO. The ORO considered that this arrangement would save it the trouble of preparing cheques to pay the agent's bills. As the debtors made their payments directly to the debt collection agent, there was little assurance that the proceeds the agent reported to the ORO represented the actual amounts collected by the agent. Audit considers that there is a need for the ORO to strengthen its control over the debts collected by the agent to ensure that all debts recovered are remitted to the ORO.

Deficiency in the contracts with the debt collection agents

3.20 Audit noted that the contract with the solicitors firm, which was appointed in June 1997 (see paragraph 3.12 above), did not specify how the outstanding insolvency cases would be handled after the expiry of the contract. As a result, the ORO allowed the firm to continue to handle 250 outstanding cases after the expiry of the contract in May 1999 with an additional handling fee

of \$1,500 per case. In the absence of information on the amounts actually recovered, Audit was unable to estimate the additional amount of fees (i.e. recovery commission) paid. Audit also noted that legal advice had not been sought before signing the contract with the collection agent.

Referral of cases to collection agents

3.21 Audit notes that, under the term of the contracts with the debt collection agents, in exceptional circumstances the ORO has the right to exclude a qualified case from the scheme. However, the Official Receiver, through internal circulars, requires the IOs to refer all winding-up cases with book debts of \$20,000 or above to the collection agent. Indiscriminate compliance with this internal requirement might not be in the best interest of the insolvent estates concerned because some debts which can be collected easily need not be referred to the agent. The following cases were noted from an audit test check:

- the debt collection agent collected \$21,404 from an insurance company by simply issuing a demand letter. The agent charged a fee of \$7,851 for the debt recovered; and
- after the ORO had provided the debt collection agent with sufficient evidence to substantiate the debts, the agent collected \$43,880 and \$60,000 from a tertiary institution and a government department respectively by simply issuing demand letters. The agent charged a fee of \$12,888 for the debts recovered.

3.22 In Audit's view, there is a need for the ORO to clearly specify, in both its internal circulars and its future contracts with the debt collection agent, the circumstances under which the ORO staff will take recovery action first (e.g. by issuing demand letters) before referring the cases to the collection agent.

Audit recommendations on realisation of assets

3.23 **Audit has *recommended* that the Official Receiver should:**

- (a) **consider setting targets, including the time taken to recover debts or the debt recovery rate, to assess the performance of the debt collection agent;**
- (b) **review and closely monitor the performance of the debt collection agent and consider appointing more than one debt collection agents at the same time in order to encourage competition;**
- (c) **require in-house staff to carry out in-depth checks to ensure that any write-off of book debts recommended by the debt collection agent is fully justified and, in particular, is in compliance with the requirements of the ORO's internal guidelines;**

- (d) **introduce controls to ensure that all debts collected by the debt collection agent are fully accounted for and are promptly remitted to the ORO (e.g. by requiring all debtors to draw their cheques payable to the ORO);**
- (e) **always first use ORO's in-house staff to collect book debts of insolvent estates, especially for those debts due from public organisations, before referring the cases to the debt collection agent; and**
- (f) **seek necessary legal advice before entering into contracts with debt collection agents.**

Response from the Administration

3.24 The **Official Receiver** has said that:

- (a) he agrees to review the setting of a time frame for closing a debt or case by the debt collection agent when the present contract with the agent is about to expire or terminate;
- (b) he agrees to consider appointing more than one debt collection agents at the same time prior to the expiry of the current contract. The ORO is presently monitoring the performance of the debt collection agents by reviewing the monthly progress reports and quarterly reports provided by them. The performance will also be critically assessed when considering renewing contract with an agent;
- (c) he agrees to ensure that any write-off of book debts recommended by the debt collection agent is fully justified. Random test would be introduced;
- (d) he agrees with the audit recommendations to introduce controls to ensure that all debts collected by the debt collection agent are fully accounted for and are promptly remitted to the ORO;
- (e) he does not agree that the ORO should always attempt to collect book debts of insolvent estates in the first instance by employing in-house resources because:
 - (i) debt collection agent's costs are paid out of the winding-up/bankruptcy estate rather than the Government's fund; and
 - (ii) if the ORO were to allocate only more difficult debts to debt collection agents, it is expected that no collection agent will be interested; and
- (f) he agrees to seek necessary legal advice before entering into contracts with debt collection agents. This will be done by the ORO's in-house lawyers.

PART 4: DISTRIBUTION OF REALISED ASSETS AND LAW ENFORCEMENT

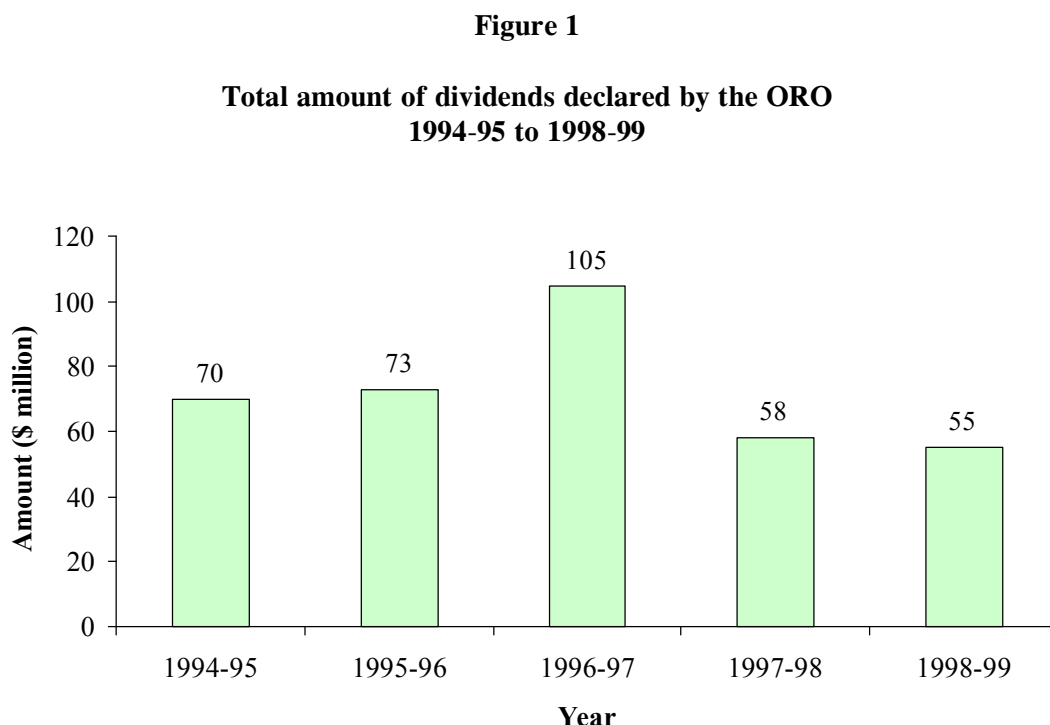
Criteria for payment of dividends

4.1 In terms of priority, funds realised from assets of bankrupts/insolvent companies are applied first towards settling the petitioners' costs, administrative expenses and fees of the Official Receiver/liquidators, and the cost for the release from trusteeship/liquidatorship. If funds are available, the Official Receiver/liquidators proceed to adjudicate the creditors' proofs of debts and pay the preferential creditors (e.g. wages and salaries of employees, and statutory debts such as taxes, water charges, rates, fines and penalties). If funds are still available, an ordinary dividend is paid to the creditors.

4.2 According to the mission statement published in its 1998-99 Annual Departmental Report, the ORO is committed to protecting and realising the assets of insolvent estates, adjudicating the claims of creditors, and distributing the proceeds to preferential and ordinary creditors in an efficient manner as soon as practicable.

Audit observations on adjudication of creditors' claims and distribution of realised assets

4.3 Audit noted that the total amount of dividends declared by the ORO had decreased substantially since 1996-97 as indicated in Figure 1 below.



Source: ORO's annual departmental reports

Estates of insolvent companies

4.4 Despite the ORO's pledge to distribute dividends as soon as practicable, a substantial amount of funds is being held by the ORO pending distribution. As at 31 July 1999, \$4,523 million of the estates of insolvent companies (including those estates handled by PIP) was placed on bank deposits in the name of the ORO, of which \$2,378 million (or 52.6%) had been held for more than one year. An age analysis of the surplus funds of insolvent estates is shown in Table 6 below.

Table 6
Age analysis of surplus funds of estates of insolvent companies
placed on bank deposits as at 31 July 1999

Age	Case		Amount (Note)	
	(Number)	(Percentage)	(\$ million)	(Percentage)
6 months or less	75	15.8%	1,675	37.0%
Over 6 months to 1 year	65	13.6%	470	10.4%
Over 1 year to 2 years	90	18.9%	2,011	44.5%
Over 2 years to 4 years	97	20.4%	93	2.1%
Over 4 years to 6 years	49	10.3%	36	0.8%
Over 6 years to 8 years	44	9.2%	62	1.4%
Over 8 years to 10 years	19	4.0%	30	0.6%
Over 10 years	37	7.8%	146	3.2%
Total	<u>476</u>	<u>100.0%</u>	<u>4,523</u>	<u>100.0%</u>

Source: Audit's analysis of ORO's records

Note: The amount of surplus funds of estates of insolvent companies was the accumulated balance of bank deposits. The age analysis was compiled based upon the date of first placement of such deposits.

4.5 Audit observations on the distribution of realised assets for estates handled by PIP are given in paragraphs 7.5 and 7.6 below. With regard to those estates handled by the ORO, in

October 1999, Audit selected four long outstanding cases with substantial surplus funds placed on bank deposits (i.e. over nine years and exceeding \$1 million) for in-depth review. Audit noted the following irregularities:

- according to the internal guidelines of the ORO, priority should be given to old cases, and the case IO should adjudicate creditors' claims immediately if there were funds available to pay a dividend in the case. However, the case IOs had apparently not followed the internal guidelines in handling the four cases in Appendix B. For these four cases, a long time was taken for the adjudication of claims;
- there was little evidence of supervisory review to follow up the apparent delay in the adjudication of claims and the distribution of dividends in the four cases in Appendix B. No explanations were documented in the case files for the delay; and
- no action was taken to expedite the completion of the four cases in Appendix B. In Case 1, the case IO did not take further action to deal with the case due to the poor response to the request for supporting evidence to substantiate the claims. In Case 3, while the case IO stated that the delay in the distribution of dividend was due to the complexity of the case, he did not take action to tackle the problem.

Estates of bankrupts

4.6 As at 31 July 1999, \$157 million in respect of 1,933 estates of bankrupts was placed on bank deposits in the name of the ORO. Audit randomly selected ten cases for in-depth review to assess the adequacy and timeliness of action taken by the ORO for the distribution of realised assets. The results indicated that:

- the ORO had properly arranged for the distribution of dividends in only three of the ten cases; and
- the ORO had not taken positive action to distribute dividends as soon as practicable in the remaining seven cases. Problems in the adjudication of creditors' claims were generally cited as the reasons for the delay in the distribution of dividends.

The need to expedite action on distribution of available funds

4.7 In Audit's view, to fulfil the ORO's mission statement as mentioned in paragraph 4.2 above, it is important that the case officers of the ORO make positive efforts to adjudicate creditors' claims and distribute dividends as soon as practicable. This is

particularly important from the angle of equity and fairness to creditors and other stakeholders because, unless the dividends are paid promptly, a significant part of the interest earned on the bank deposits of the insolvent estates is paid to the general revenue in accordance with the law (see the third inset of paragraph 8.1 below).

Audit recommendations on adjudication of creditors' claims and distribution of realised assets

4.8 **Audit has *recommended* that the Official Receiver should:**

- **take immediate action to review all insolvency cases with substantial cash balances to ascertain if there are any other cases where there is undue delay in the distribution of dividends to the creditors;**
- **closely monitor the progress of the distribution of realised assets in future and take prompt action to ensure that surplus funds of insolvent estates are distributed to creditors and shareholders at the earliest opportunity;**
- **where it is not practicable to complete the distribution of all dividends at an early date, consider minimising the effect of delay on creditors by paying interim dividends; and**
- **set performance targets for the time taken (e.g. within a specified period) for the distribution of interim and final dividends after the realisation of assets.**

Response from the Administration

4.9 The **Official Receiver** has said that he agrees with the audit recommendations on the adjudication of creditors' claims and distribution of realised assets. Regarding the audit observations that the total amount of dividends declared had decreased substantially since 1996-97, he has said that the amount of dividends declared would be affected by the amount of assets realised in the insolvent estates. With the introduction of the Panel A Scheme in May 1996 and the Panel B Scheme in September 1997, most winding-up cases after 1996-97 with assets have been handled by PIP.

Law enforcement by the ORO

4.10 The ORO is responsible for investigating the affairs of bankrupts and officers of insolvent companies, taking appropriate action to prosecute persons for insolvency offences, and applying for

the disqualification of directors whose conduct is such that it renders them unfit to manage companies.

4.11 The legal officers of the ORO are authorised to lay information before a magistrate in respect of any alleged offences under the Companies Ordinance and the Bankruptcy Ordinance. They act generally on behalf of the Secretary for Justice as public prosecutors.

Audit observations on law enforcement by the ORO

4.12 Audit noted that the percentage of the number of prosecutions and disqualification proceedings to the number of winding-up orders and bankruptcy orders had dropped significantly in 1998-99 as shown in Table 7 below.

Table 7
Prosecutions and disqualification proceedings
1994-95 to 1998-99

Year	Number of prosecutions under		Number of disqualification proceedings	Total	Number of winding-up and bankruptcy orders	Percentage
	Bankruptcy Ordinance	Companies Ordinance				
	(a)	(b)	(c)	(d) = (a) + (b) + (c)	(e)	(f) = $\frac{(d)}{(e)} \times 100\%$
1994-95	2	104	4	110	754	14.6%
1995-96	3	93	56	152	1,013	15.0%
1996-97	12	125	41	178	1,119	15.9%
1997-98	17	106	42	165	1,102	15.0%
1998-99	8	154	27	189	1,942	9.7%

Source: ORO's annual departmental reports

4.13 Audit notes that the ORO does not differentiate between the resources used on the administration of insolvency cases and those on general law enforcement. It does not maintain records on the resources used on law enforcement work. In view of the increase in the number of

bankruptcy and winding-up cases in recent years, Audit considers that the ORO should state clearly the resources allocated to law enforcement work and compile data on the resources used in connection with its various law enforcement activities. There is a need for the ORO to maintain records on the respective performance of the Legal Services Divisions and the CMD with a view to identifying potential bottleneck or risk areas for improvement possibly by a re-allocation of resources (see also paragraph 3.6 above). There is also a need to conduct regular supervisory reviews.

4.14 To further improve work efficiency, Audit considers that the ORO can make reference to successful practices of overseas insolvency administrators. Audit notes that, in general, overseas insolvency administrators attach a high degree of importance to the work of law enforcement and prosecution. Their work reports invariably give extensive description of the law enforcement achievements. The overseas insolvency administrators are also anxious to adopt measures to improve their work. For example, the Insolvency Service of the United Kingdom launched a “hot line” facility in 1997-98 to enable the public to provide information on people whom they believed were acting in breach of disqualification orders.

Audit recommendations on law enforcement by the ORO

4.15 **Audit has *recommended* that the Official Receiver should:**

- **maintain records of the resources used on the ORO’s law enforcement activities;**
- **set performance standards for law enforcement activities;**
- **conduct regular supervisory reviews on the work of the case IOs and legal officers to ensure that the time spent by them on law enforcement work is in accordance with the level pre-determined by the management; and**
- **review and adjust the resources allocated to law enforcement work in the light of changes in the economy and public expectations, and the actual prosecution and conviction rates of insolvency offences.**

Response from the Administration

4.16 The **Official Receiver** has said that he agrees with all the audit recommendations on the law enforcement by the ORO.

PART 5: PERFORMANCE MEASUREMENT AND SERVICE DELIVERY

Performance measurement

5.1 The ORO measures its operational performance by means of performance targets and performance indicators. A comparison of the performance targets of the ORO as shown in the Annual Estimates and the extent to which these targets had been met in 1993-94 and 1998-99 is at Appendix C. A comparison of the key performance indicators of the ORO for 1993-94 and 1998-99 is at Appendix D.

5.2 According to the Annual Estimates for the year ending 31 March 2000, the ORO will closely review existing targets of performance pledges and determine any new areas for improvement.

Audit observations on performance measurement

Need for setting more challenging targets

5.3 Audit noted that the performance targets were mainly based on response time. As indicated by Appendix C, the ORO had managed to meet most of the pledged service standards introduced since its establishment in June 1992. However, the ORO has not revised the performance targets to reflect the present-day circumstances. For example, the ORO has not revised the target response time. For bankruptcy and winding-up searches, the target response time in 1999, same as six years ago, was still one day for a search conducted in person. In Audit's view, there is a need for the ORO to review its performance targets from time to time with a view to setting more challenging targets.

Need for additional performance indicators and targets

5.4 The existing performance indicators and targets do not refer to the time the ORO is expected to complete the main processes of the insolvency work. In Audit's view, to improve management control and accountability of the ORO, there is a need to set performance indicators and targets on the time required to complete the main processes of the insolvency work (see paragraph 2.16 above). For example, performance targets can be set on the time taken for the distribution of interim and final dividends to ordinary creditors. Performance target such as "xx% of the cases will be completed within xx months" can also be set to monitor the time taken to complete an insolvency case (Note 5).

Note 5: *For example, the Insolvency Service of the United Kingdom lays down a performance target that no more than 9% of open cases are to be more than 3 years old. The New Zealand Insolvency and Trustee Service also sets performance targets and provides information on actual time taken to complete the administration of all insolvency cases by stating the percentage of open cases that are 6 months to 1 year old, 1 to 2 years old and 2 to 3 years old.*

Need for conducting regular user surveys

5.5 In May 1999, the ORO commissioned the Civil Service Training and Development Institute (CSTDI) to conduct a study on Phase I of its Customer Service Enhancement Project. The CSTDI study included a questionnaire survey with the three main groups of users of the ORO's services (i.e. creditors, bankrupts and directors of insolvent companies). In respect of the delivery of services, the CSTDI survey found that the relatively long waiting time for getting counter and telephone enquiry services caused frustration and dissatisfaction among users. The users also considered that the crowded condition in the reception area for making enquiries and completing forms, the administration of oaths in the public area, and the holding of interviews in shared offices intruded on their privacy.

5.6 Apart from the CSTDI survey, Audit noted that the ORO had not conducted other user surveys to assess the needs of the general public since its establishment in June 1992. Audit notes that the ORO is currently working on the proposal of allowing the public to have on-line access to its computerised Management Information System (see paragraph 5.11 below). However, the ORO has not conducted a survey to assess users' requirements. Audit considers that there is a need for the ORO to ascertain the specific demands of its service users for on-line search facilities. There is also a need for the ORO to ascertain regularly the level of user satisfaction and demands in planning the allocation of the ORO's resources.

Audit recommendations on performance measurement

5.7 **Audit has *recommended* that the Official Receiver should:**

- **use modern methodology including information technology to achieve productivity improvements in the longer term (see paragraph 5.11 below);**
- **conduct regular customer surveys to ascertain the level of customers' satisfaction of the existing ORO services and their demand for better services;**
- **take into account customer needs in the ORO's strategic plan for possible improvement of services; and**
- **having regard to customer needs and the performance pledges of overseas insolvency administrators, conduct a review to ascertain whether improvements can be made to the existing performance pledges of the ORO (e.g. introducing new or additional performance measures on law enforcement and adopting performance indicators which better reflect the progress of different processes of the insolvency work).**

Response from the Administration

5.8 The **Official Receiver** has said that he agrees with the audit recommendations on the performance measurement. He has also said that:

- the target response time of one working day for a search in person was made in 1993 when there were 140 applications being processed per day. There was a drastic increase in searches from 190 per day in 1998 to 398 in 1999 and the manpower resources of the ORO had been fully stretched to meet this increase of workload;
- in view of the huge demand and given the current processing capacity provided by the Official Receiver's Management Information System, the ORO could only maintain the present performance pledge of one working day; and
- when the enhancement for the current computer system is completed, a review would be carried out to reduce the service delivery time.

Development of on-line search facilities

5.9 The ORO provides the following two types of search services for compulsory winding-up/bankruptcy records to the general public:

- ***Search in person.*** A person can submit a search application and each application can search for the records of a company or a person at a time. According to the ORO's performance pledge, a searcher who hands in his search application can obtain the requested information (e.g. case number, date of first hearing of petition and date of adjourned hearing) on the next working day; and
- ***Search by post.*** A person who sends in a search application by post will be asked to collect his requested information three working days after the receipt of the search application.

For each search in person or by post, the fee is \$85.

5.10 Over the years, the number of public searches had increased significantly from 29,784 in 1994 to 55,053 in 1998. The ORO estimated that it would process more than 95,000 searches in 1999.

5.11 Because of the increase in demand for search services, the ORO was not always able to meet its performance pledge in its service delivery. According to the ORO's 1998-99 Annual Departmental Report, 2,619 public searches could not be processed within the target of one working day. In June 1999, the Departmental Administration Division proposed to use the ORO's Management Information System as an interface for the development of electronic service delivery to cope with the increased demand for bankruptcy/winding-up searches. The proposed system was considered to have the following benefits:

- the general public could make on-line applications for search at any time. The on-line search reports would be available immediately after payment;

- the quality and efficiency of public search would be greatly improved; and
- there would be savings in staff resources.

The proposal is now being considered by the ORO.

Audit observations on development of on-line search facilities

5.12 The clerical staff of the Departmental Administration Division of the ORO are responsible for operating the search system for bankruptcy and winding-up records. Audit estimates that the cost of providing the public search services is about \$1 million in 1999-2000.

5.13 In Audit's view, there is a need for the ORO to conduct a comprehensive user survey to ascertain the specific demands of users for on-line search facilities before finalising the computer development plan (see paragraph 5.6 above). To ensure a smooth and speedy implementation of the proposed on-line search facilities, there is also a need for the ORO to draw on the experience and expertise of other government departments and overseas insolvency administrators in the development of similar facilities (Note 6).

Audit recommendations on development of on-line search facilities

5.14 Audit has *recommended* that the Official Receiver should:

- critically assess the feasibility of developing on-line search facilities, having regard to their cost-effectiveness and their impact on the availability of service delivery; and
- take into account customer demands and draw on the experience of other government departments and overseas insolvency administrators in the planning and development of on-line search facilities.

Response from the Administration

5.15 The **Official Receiver** has said that he agrees with the audit observations and recommendations on the development of on-line search facilities. He has also said that the ORO put up a proposal to install an on-line search via the Electronic Service Delivery Infrastructure and this had been endorsed by the Administration. Subject to voting of funds by the Finance Committee of the Legislative Council, the feasibility study for the project would be carried out in 2000-2001.

Note 6: *The Insolvency and Public Trustee's Office of Singapore operates an Internet Insolvency Search Service. The Insolvency and Trustee Service of Australia provides direct on-line search facilities through appointed information brokers.*

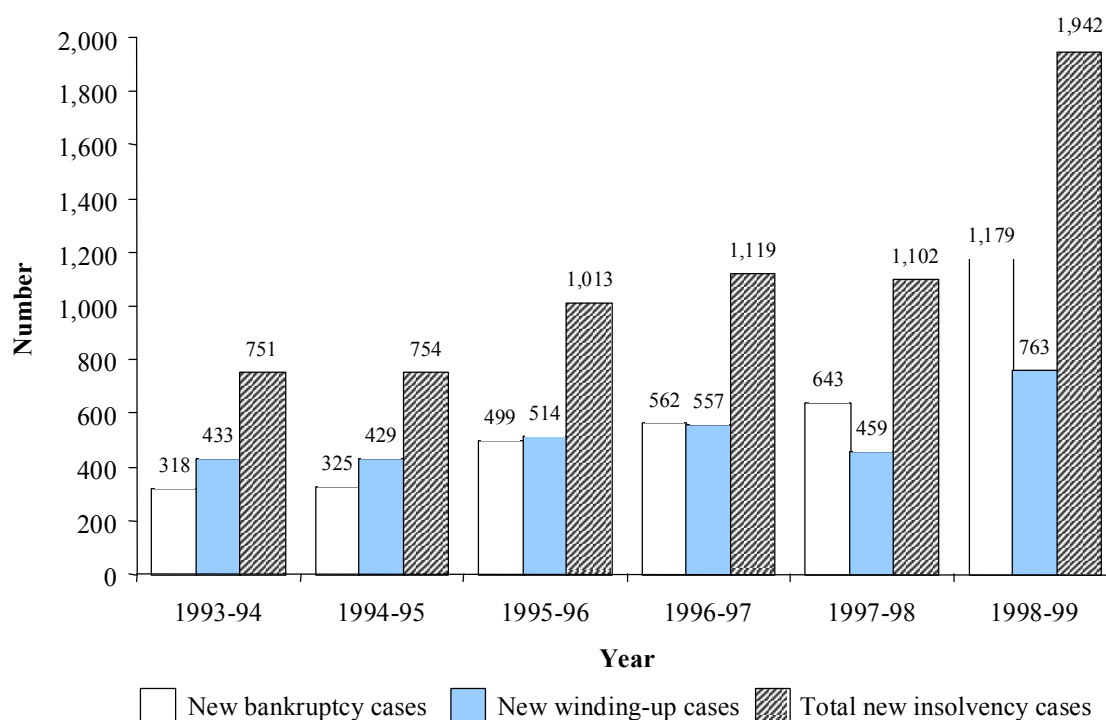
PART 6: APPOINTMENT OF PIP TO HANDLE INSOLVENCY CASES

Increasing workload of the ORO

6.1 By law, the ORO is required to administer compulsory liquidation and individual bankruptcy cases. It has no control over the number of insolvency cases assigned to it by the court. In 1998-99, there were 1,942 new insolvency cases, an increase of 840 cases over those of 1997-98. To cope with the increasing workload (see Figure 2 below), the ORO has adopted different schemes to appoint PIP to take up part of its workload.

Figure 2

Number of new insolvency cases 1993-94 to 1998-99



Source: ORO's annual departmental reports

Appointment of PIP

Appointment of PIP as liquidators

6.2 For compulsory winding-up cases with estimated realisable assets exceeding \$200,000, creditors and contributories of the company may apply to the court for the appointment of PIP as liquidators. Before May 1996, the Official Receiver was usually selected as the liquidator. Since May 1996, the ORO has operated a Panel A Scheme for the appointment of PIP (mainly

accountancy firms) as the liquidators for compulsory winding-up cases with estimated realisable assets exceeding \$200,000. Under the Panel A Scheme, the ORO maintains a list of approved accountancy firms. Creditors are encouraged to select PIP, recommended by the ORO based on its approved list and on a roster basis, to act as liquidators. In most cases, the creditors' meeting selects the firm recommended by the ORO as the liquidator.

Appointment of PIP as agents for the ORO

6.3 In September 1997, the ORO implemented a Pilot Panel B Scheme to appoint PIP as agents for the ORO in the administration of compulsory winding-up cases with estimated realisable assets not exceeding \$200,000. The Official Receiver remains as the liquidator. In 1999-2000, the Government approved \$21 million to enable the ORO to turn the pilot scheme into a regular and continuous Panel B Scheme for the appointment of PIP for 400 company liquidation cases with effect from April 1999.

6.4 The appointment of PIP under the Panel B Scheme is based on an approved list and on a roster basis similar to that of the Panel A Scheme. Under the appointment procedures, PIP can receive a maximum subsidy of \$60,000 from the ORO to meet the liquidation costs for each winding-up case.

Audit observations on the appointment of PIP

6.5 From 1996-97 to 1998-99, PIP were appointed to act as liquidators or agents for 242 cases as shown in Table 8 below.

Table 8

**Number of cases handled by PIP
1996-97 to 1998-99**

Year	As liquidator under Panel A Scheme	As agent for the ORO under Pilot Panel B Scheme	Total
1996-97	17	—	17
1997-98	22	96	118
1998-99	22	85	107
Total	<u>61</u>	<u>181</u>	<u>242</u>

Source: ORO's records

6.6 Audit notes that the ORO has an approved list of private sector firms and the appointment of liquidators for Panel A cases and the appointment of agents for Panel B cases are on a roster basis. According to the ORO, this practice was adopted to expand the pool of experienced insolvency practitioners in Hong Kong. However, under a roster system, there is no competition among the firms in the ORO's approved list. In terms of value for money, there is inadequate assurance that the existing arrangements would result in the selection of the firm which offers the most competitive fee for its services.

Audit recommendations on the appointment of PIP

6.7 Audit has *recommended* that the Official Receiver should consider ways of ensuring that competitive bids are received from PIP before they are appointed. In particular, the Official Receiver should:

- having regard to similar working experience of the ORO's in-house staff and prevailing market conditions, establish standard cost rates to enable the ORO to assess the fees offered by PIP; and
- critically consider whether it is practicable and cost-effective to replace the existing roster system of appointing PIP with a tender system of appointment based on competitive bidding.

Response from the Administration

6.8 The **Secretary for Financial Services** has said that he is planning to move from the roster system to a tender system. He has also said that:

- the Pilot Panel B Scheme was meant to test the market response to the appointment of PIP for "non-remunerative" summary winding-up cases with estimated realisable assets not exceeding \$200,000. Insolvency work is specialised in nature and hitherto has been undertaken largely by a few accountancy firms. One of the main objectives of the Scheme is to enlarge the pool of insolvency expertise in the private sector. If tender procedure is adopted at an early stage, the scheme is likely to be monopolised by a few bigger firms on the Panel because of their ability to offer "more competitive" bid due to economy of scale, hence defeating the policy objective. The roster system is preferred because it ensures an equitable allocation of cases to the Panel firms and thereby, in time, helps to build up a larger pool of expertise; and
- having operated the Panel B Scheme for one full year, he has conducted a review of the Panel B system. In order to meet the Government's policy objective to enlarge the pool of insolvency expertise in the private sector, he is planning to lower the pre-qualification criteria for Panel B firms having regard to the nature and the minimal amount of assets involved in the vast majority of the Panel B cases. He believes that this would encourage more new participants to join the Panel B Scheme. In parallel, he is planning to move from the roster system to a tender system but any tender system that may emerge in due course must ensure that there is ample competition within the Panel and that the scheme would not be monopolised by a few big firms.

PART 7: MONITORING OF PERFORMANCE OF PIP AND THEIR FEES

Monitoring of performance of PIP as liquidators

7.1 Under section 204 of the Companies Ordinance, the Official Receiver shall take cognizance of the conduct of liquidators of companies being wound up by the court. The Official Receiver shall enquire into the matter and take actions if the liquidator does not faithfully perform his duties, or if any complaint is made to the Official Receiver by any creditor or contributory of the companies. The Official Receiver is empowered to require PIP as liquidators to answer any enquiries in relation to any winding-up cases in which they are engaged. The Official Receiver may also direct investigations to be made of the books and vouchers of the liquidators.

Accounts and reports submitted by PIP as liquidators

7.2 As at 31 July 1999, there were 189 compulsory winding-up cases administered by PIP as liquidators. The proceeds of realised assets of the insolvent estates of these cases were paid into the Companies Liquidation Account kept by the Official Receiver under section 293 of the Companies Ordinance. The ORO is responsible for authorising payments from the Companies Liquidation Account and monitoring the progress of liquidation.

7.3 Under section 203 of the Companies Ordinance, PIP as liquidators should submit their accounts in a prescribed format to the ORO twice a year with such vouchers and information as the Official Receiver may require. In addition, under rule 162 of the Companies (Winding-up) Rules, PIP as liquidators shall also forward to the Official Receiver, with their accounts, a report upon the position of the liquidation of the company in such form as the Official Receiver may direct.

7.4 The ORO may audit the accounts submitted by PIP as liquidators or may decide that the accounts need not be audited. According to the internal guidelines of the ORO, accounts which meet certain specific criteria are audited by the ORO. The ORO also audits a random sample of 10% of those cases which do not fall within the selection criteria. The remaining cases are briefly checked to confirm that they are prima facie correct and in order against the cash books of the insolvent estates.

Audit observations on monitoring of performance of PIP as liquidators

7.5 Out of the 37 cases with \$146 million surplus funds which had been placed on bank deposits for more than ten years as at 31 July 1999 (see Table 6 in paragraph 4.4 above), there were 22 long outstanding liquidation cases handled by PIP as liquidators. Audit's review of these 22 cases indicated that the ORO had not taken adequate and effective action to monitor the performance of PIP as liquidators. Audit noted the following irregularities:

- 19 liquidators explained to the ORO that the delay in winding-up of the companies concerned was due to problems in the realisation of assets or inter-company debts. However, the ORO was not informed of the specific steps taken to follow up these cases and the expected dates of completion of action. The ORO was also not provided with information on the value and types of assets to enable the ORO to determine whether the

time taken to realise the assets was reasonable. In response to the ORO's enquiries with the liquidators concerned, only 11 liquidators indicated that they would take follow-up actions;

- in the realisation schedules of seven cases in which the liquidators reported that they had problems in realisation of assets, it was stated that the “estimated value of assets not yet realised” was zero. In response to the ORO's follow-up action with the liquidators concerned, one liquidator replied that there were no outstanding assets pending realisation and that he would take action to finalise the case; and
- there were eight cases (which had case numbers assigned to them from 1983 to 1985), each case of which had an estate balance of over \$6 million as at 31 July 1999. Details are given in Table 9 below.

Table 9

**Long outstanding cases handled by
PIP as liquidators with estate balances over \$6 million
Position as at 31 July 1999**

Case	Year in which case number assigned	Estate balance as at 31 July 1999 (\$ million)	Last dividend payment date	Total interim dividends paid (\$ million)
1	1985	7.08	No dividend was declared	—
2	1985	7.67	No dividend was declared	—
3	1985	6.55	September 1988	0.08
4	1984	26.66	January 1991	19.41
5	1984	10.05	March 1993	8.21
6	1984	10.30	June 1994	40.57
7	1983	23.66	February 1996	58.26
8	1983	7.07	February 1996	66.12
Total		<u>99.04</u>		

Source: ORO's records

7.6 According to its mission statement, the ORO is committed to monitoring the conduct of PIP in compulsory liquidations and ensuring that they carry out their duties as effectively and expeditiously as possible. In Audit's view, there is a need for the ORO to take more proactive action in its review of the accounts submitted by PIP as liquidators so that any problems are resolved at an early date. In particular, the ORO needs to ensure that PIP as liquidators distribute dividends as soon as practicable (see paragraph 4.7 above).

Audit recommendations on monitoring of performance of PIP as liquidators

7.7 **Audit has recommended that the Official Receiver should:**

- **critically examine the accounts submitted by PIP as liquidators to ensure that they are correct and take expeditious action to follow up any anomalies in the accounts; and**
- **closely monitor and follow up any outstanding items at every stage of the liquidation process to ensure that there is no undue delay on the part of PIP as liquidators, particularly in the distribution of dividends.**

Response from the Administration

7.8 The **Official Receiver** has said that the present practice is to strictly enforce the requirement under section 203 of the Companies Ordinance for certification of the accounts submitted by PIP as liquidators. He has also said that:

- the accounts submitted by PIP as liquidators are examined by the ORO during the audit of the said accounts. A proforma set of accounts and related guidelines are available for PIP as liquidators; and
- with regard to the 22 cases handled by PIP mentioned in paragraph 7.5 above, it should be noted that interim dividend payments have been made in many of these cases. It should also be noted that prior to the court's decision in 1998 (see paragraphs 7.16 to 7.18 below), it was assumed that the timely payment of dividends in such liquidations was the duty of PIP as liquidators. The ORO was not required to take a proactive role in the matter.

Monitoring of performance of PIP as agents for the ORO

7.9 When PIP are appointed as agents for the ORO under the Panel B Scheme, they are required to submit their first reports to the ORO within eight weeks from the dates of appointment. These reports are reviewed by the case IOs concerned and all observations are then referred to their supervisors for consideration. The ORO also requires the appointed PIP to submit progress reports and summaries of accounts every four months from the dates of their appointment. The summaries

of accounts are reviewed by the case IOs in detail and all observations are submitted to their supervisors for consideration.

Audit observations on monitoring of performance of PIP as agents for the ORO

7.10 Audit noted that the ORO had not issued guidelines on how the case IOs should review the progress reports and summaries of accounts submitted by PIP under the Panel B Scheme. The ORO's operational staff informed Audit that they spent little time in reviewing and conducting investigation on the progress reports submitted by such practitioners. Nevertheless, they paid particular attention to the fees charged by PIP and would actively seek additional information about doubtful cases.

7.11 In Audit's view, to ensure that the performance of PIP appointed under the Panel B Scheme is up to the required standard, there is a need to issue guidelines specifying the monitoring work to be carried out by the case IOs.

Audit recommendations on monitoring of performance of PIP as agents for the ORO

7.12 Audit has *recommended* that the Official Receiver should:

- issue guidelines to case IOs on how they should monitor the performance of PIP appointed under the Panel B Scheme; and
- closely monitor the work of PIP appointed under the Panel B Scheme to ensure that their performance is up to the required standard and their charges are reasonable.

Response from the Administration

7.13 The **Official Receiver** has said that he agrees with the audit recommendations on the monitoring of performance of PIP as agents for the ORO. He has also said that:

- guidelines have been issued to IOs by way of technical circulars and the standard form of appointment letter which sets out what the appointed agent is required to do;
- with reference to the above guidelines, the performance of Panel B practitioners and progress of their work are being supervised and reviewed through the 4-monthly reports submitted by them. It is the current practice for the IOs to carefully study the progress reports and thereafter report any irregularities and unsatisfactory performance to their senior officers for appropriate action (e.g. issuing warning); and

- Panel B agents are required to submit their bills in the format prescribed by the ORO, which contain the necessary information to enable the IOs to check the reasonableness of their charges.

Fees and disbursements charged by PIP as liquidators

7.14 As shown in Table 10 below, fees and disbursements charged by PIP as liquidators of insolvent companies accounted for 67% of the total amount of expenditure charged to the insolvent estates in 1998-99.

Table 10

Estimated expenditure charged to insolvent estates in 1998-99

Description	Amount	
	(\$ million)	(Percentage)
Fees charged by PIP as liquidators	130	27%)
) 67%
Expenses and disbursements incurred by PIP as liquidators	190	40%)
Fees charged by the ORO (including bank interest on insolvent estates)	125	26%
Expenses and disbursements incurred by the ORO	35	7%
Total	<u>480</u>	<u>100%</u>

Source: ORO's records and Audit's estimate

7.15 In October 1997, the ORO issued a circular (i.e. ORO Circular No. 1/97) setting out for the first time the procedures for PIP to follow when they requested payment of liquidators' remuneration from the Companies Liquidation Account. This circular states that fees by way of time costs can be authorised only when the liquidators' bills of costs are accompanied by:

- a summary of work done during the period covered by the bill;
- the number of hours incurred by respective grade of staff;

- hourly charge-out rate for the different grades of staff engaged in the liquidation work;
- total fees per grade of staff; and
- a list of the disbursements or out-of-pocket expenses incurred.

7.16 In March 1998, the court expressed concern about the level of fees and disbursements for which approval was sought by PIP acting as provisional liquidators in connection with the liquidation of a group of companies. The fees and disbursements of the provisional liquidators, which included those of two firms of solicitors instructed by the provisional liquidators, were about \$76 million for a period of 63 days (i.e. from the date of the appointment of provisional liquidators to the date of the winding-up orders). The court stated that it was greatly troubled by the large amount involved.

7.17 In November 1998, the court expressed its view that:

- the Official Receiver should be a party to the taxation of the solicitors' bills (Note 7). He should be served with copies of the bills and should have the right to object; and
- the Official Receiver was the appropriate person to assist the Taxing Master appointed to review the bills of the provisional liquidators.

7.18 In response to the Official Receiver's comment that the ORO could not undertake the above-mentioned task without additional resources, the court said that:

- whatever the practice might have been in the past, it was clearly the responsibility of the Official Receiver to assume an active role in ensuring that any bills or charges which were rendered by the liquidators and their professional advisers were subjected to satisfactory scrutiny. This contemplated that where any bill was taxed by the Taxing Master, the Official Receiver should attend the taxation and oppose any items which appeared to him to be either unjustified or excessive in amount;

Note 7: *The bill of costs, including charges, disbursement and remuneration, incurred in a winding up by the court shall be taxed (i.e. examined and assessed) by the Taxing Master of the court. The Official Receiver shall call the attention of the liquidator to any items in the bill which, in his opinion, ought to be disallowed or reduced, and may attend or to be represented on the taxation.*

- if the Official Receiver found that his available resources were inadequate for him to discharge his duties in a satisfactory manner, he should as a matter of urgency apply to the relevant authorities to make good any deficiencies;
- the provisional liquidators could not simply list the total number of hours spent by themselves and the fee-earning members of their staff and apply their normal charging rates; and
- the provisional liquidators must explain exactly what they did, why they did it and why they continued on any particular course if it turned out not to be advantageous. For that, they must keep proper records of what they had done and why they had done it.

7.19 In the light of the court case, the ORO considered that it was necessary to review the guidelines on the preparation of the liquidators' bills. In November 1998, the Official Receiver issued the ORO Circular No. 2/98 (which superseded ORO Circular No. 1/97) to PIP requiring them to provide details to justify and prove their time-cost charges. PIP were required to submit their bills of costs in summary form showing:

- the main activities of work performed analysed into different categories;
- the cross referencing to the main activities of work performed;
- all disbursements or out-of-pocket expenses incurred with suitable explanations; and
- the certification of any solicitors' bills.

7.20 However, the above requirements were subsequently withdrawn because in May 1999, the court held that ORO Circulars No. 1/97 and No. 2/98 were ultra vires the powers of the Official Receiver where they were not purely administrative in nature but purported to affect the substantive rights of the parties. The circulars had no effect and could not operate to validate payments made thereunder or prevent them from being re-opened at the instance of the court because the relevant powers were not conferred on the Official Receiver by the law. At present, the hourly rates charged by PIP are approved by the Official Receiver in consultation with the Hong Kong Society of Accountants.

Audit observations on fees and disbursements charged by PIP as liquidators

7.21 Audit noted that, before the issue of ORO Circular No. 2/98 in November 1998, the ORO had not issued any guidelines requiring liquidators to submit detailed justifications for their time-cost charges. While ORO Circular No. 1/97 dealt with time-cost charges, it did not require PIP to provide details to substantiate their time-cost charges.

7.22 As the court had held that ORO Circular No. 2/98 was ultra vires, there are presently no guidelines issued by the ORO to PIP indicating how they should prepare their bills. In the absence of guidelines, it is questionable whether the present system of recording time-cost charges meets the requirement of the court. Audit also has reservations as to whether the interests of creditors are fully protected.

7.23 Audit notes that the ORO, with the assistance of a Working Group (Note 8), is now drafting a new circular on liquidators' remuneration. The ORO plans to include the following requirements in the new circular:

- the liquidators should prove to the ORO and to the creditors at the creditors' meeting or the Committee of Inspection that they have a proper time-recording and billing system in place that enables them and their staff to input contemporaneous task for each unit of time spent; and
- sufficient information should be provided to enable the creditors or the Committee of Inspection to form a judgement as to whether their proposed fees are reasonable having regard to all the circumstances of the case.

7.24 The court recognised that the ORO had an important role to play in the assessment of liquidators' fees and disbursements. However, the ORO had seldom exercised its right to attend or be represented in the assessment process in the past (see paragraphs 7.17 and 7.18 above). In Audit's view, in order to fulfil its statutory duties, the ORO should participate actively in the assessment of fees, particularly in those cases where large amounts of fees may be charged by liquidators.

Note 8: *In May 1999, a Working Group on insolvency practitioner's remuneration chaired by the Official Receiver was set up. Members of the Working Group included the two Assistant Official Receivers of the ORO, three members from the Hong Kong Society of Accountants and two members from the Hong Kong Law Society. The Working Group aimed to come up with a set of recommendations in six months' time.*

Audit recommendations on fees and disbursements charged by PIP as liquidators

7.25 **Audit has *recommended* that the Official Receiver should:**

- **expedite the process of issuing guidelines to PIP as liquidators on the billing of time-cost fees and other liquidation fees;**
- **take an active role in the assessment of liquidators' fees and disbursements so as to ensure that the liquidators' bills are properly supported; and**
- **design assessment procedures for assisting ORO staff in vetting liquidators' fees so as to ensure uniformity of practice among different case management teams.**

Response from the Administration

7.26 The **Official Receiver** has said that the ORO has formed a Working Group to draw up guidelines to assist the ORO staff in vetting liquidators' fees. The guidelines are being finalised and can be issued shortly. He has also said that:

- the ORO and the Hong Kong Society of Accountants are working on a joint circular which will provide guidelines for PIP as liquidators on the necessary information they should provide to the ORO to support their time-cost fees. The circular is being finalised and will be issued after it has been cleared with the court; and
- he agrees to take an active role in the assessment of liquidators' fees and disbursements. The ORO will continue to process liquidators' fees and disbursements in accordance with ORO Circular No. 2/98 until it has been replaced by the joint circular.

PART 8: FEES CHARGED BY THE ORO

Fees charged on insolvent estates

8.1 The ORO charges the following main items of fees to the insolvent estates:

- for estates administered by the ORO, a realisation fee of 10% on the total assets realised and a distribution fee of 5% of the dividends distributed. For creditor petitioned insolvency case, a minimum fee of \$12,150 is charged if the case has insufficient assets in the estates. The petitioner is required to pay a deposit to the ORO to cover the ORO's fees and expenses when he lodges a petition for bankruptcy or company liquidation;
- an ad valorem fee levied on a graduated scale with progressively reducing rates from 10% to 1% on the aggregated amount of realised assets of estates administered by the ORO or by the PIP as liquidators; and
- bank interest earned from the placement of insolvency monies of all the insolvent estates with licensed banks. For all bankruptcy estates and those company liquidation estates with value not exceeding \$100,000, the entire amount of interest earned is kept by the ORO. For company liquidation estates with value exceeding \$100,000, an amount equal to 1.5% per annum of the monies invested is collected by the ORO.

As shown in Table 10 in paragraph 7.14 above, fees charged by the ORO in 1998-99 amounted to about \$125 million. This amount was about 26% of the total expenditure charged to all insolvent estates.

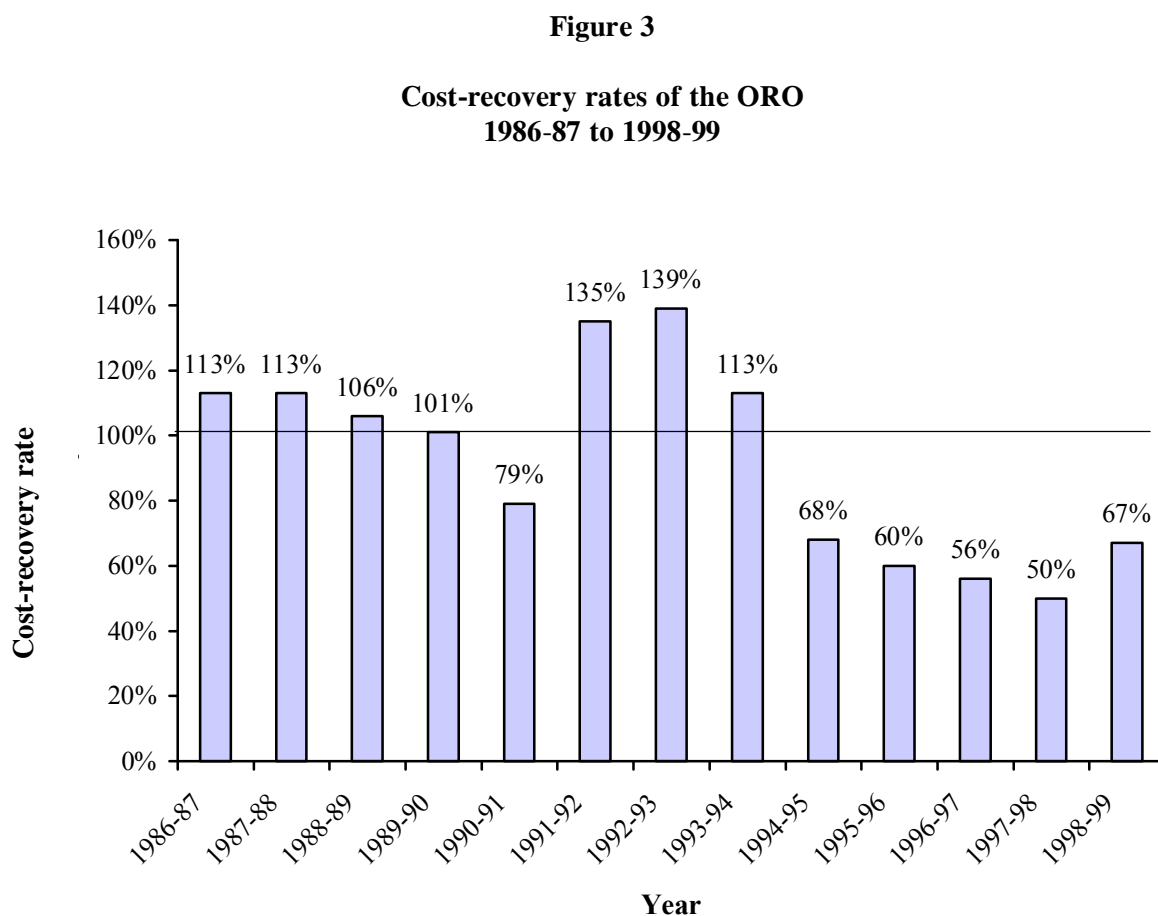
The need to achieve cost recovery

8.2 It is government policy that fees charged by the Government should in general be set at levels which can recover the full cost of providing such services. However, the ORO has a long history of not being able to recover fully its operating costs.

8.3 In June 1987, in connection with the proposed introduction of a new scale of ad valorem fees, the Administration informed the Executive Council that the question of cost recovery had been examined. The then Registrar General estimated that the total income (including the proposed ad valorem fees) would result in a cost-recovery level of some 74%. The Administration considered that full-cost recovery was not possible at that stage. However, the Administration informed the Executive Council that it intended to review the fees in two years' time (see paragraph 8.9 below).

8.4 As it turned out, the cost-recovery rates achieved by the ORO from 1986-87 to 1993-94 were mostly higher than 100%. However, since 1994-95, the cost-recovery rates had fallen below

70%, with the lowest of 50% recorded in 1997-98. The total operating deficit of the ORO for 1994-95 to 1998-99 amounted to \$353 million. Figure 3 below shows the cost-recovery rates from 1986-87 to 1998-99.



Source: ORO's records

8.5 In May 1995, the Official Receiver submitted fee revision proposals to the Secretary for the Treasury. He said that:

- most of the proposals were to revise the fees in line with the inflation rate since the last revision;
- assuming that the ORO's fee proposals would be implemented in November 1995, the cost-recovery rate for 1995-96 was estimated to be 52%. It was lower than the actual cost recovery of 68% achieved in 1994-95 due to:
 - (i) a decrease in the amount of funds in insolvent estates which attracted interest;

- (ii) a 10% salary revision on cash costs (salaries and allowances) and non-cash costs (payroll oncost); and
- (iii) the absence of major and complex liquidation cases which reduced the amount of fees on asset realisation and distribution recovered by the ORO; and
- given that the above factors were completely outside the control of the ORO, he proposed that the previously-agreed 70% cost-recovery target, which was no longer realistic, be removed.

8.6 In February 1996, the Secretary for the Treasury informed the Official Receiver that:

- a cost-recovery target was important in providing a yardstick for measuring performance and a basis for the annual fee revision; and
- the ORO should:
 - (i) identify which services were justifiable for full-cost recovery and which merited government subsidy;
 - (ii) look for an optimal level of minimum charge which would seek to contribute to a reasonable level of cost recovery and at the same time would not deter insolvency applications;
 - (iii) review the present liquidation and bankruptcy procedures with a view to simplifying the procedures; and
 - (iv) evaluate whether part of the procedures (e.g. adjudication of claims) would be contracted out to PIP.

8.7 In May 1996, the ORO set up a Working Group consisting of members from the ORO and the Financial Services Bureau to determine a revised cost-recovery percentage. In July 1999, the Official Receiver informed the Secretary for the Treasury of the result of the review. He proposed that the cost-recovery rate be revised from 70% to 50%. In October 1999, the Secretary for the Treasury and the Secretary for Financial Services both agreed that the cost-recovery rate for the ORO would be set at 60%. The Secretary for the Treasury informed the Official Receiver that:

- it was unfair to ask general taxpayers to subsidise heavily the ORO services without limit for the benefit of creditors of bankrupt persons and insolvent companies;

- the average cost-recovery rate achieved by the ORO during 1995-96 to 1998-99 was 61.9%. The Finance Bureau (FB) considered it reasonable to set a cost-recovery target rate of 60%, excluding notional revenue and costs of non-chargeable activities (e.g. law enforcement work); and
- the ORO should endeavour to carry out a fundamental review of its operations and implement cost-cutting measures.

Audit observations on fees charged by the ORO

8.8 For the period June 1992 to March 1999, the total operating deficit of the ORO amounted to \$300 million. In 1998-99, the total full-cost expenditure (Note 9) of the ORO was \$203 million, of which the Government subsidised \$67 million. The cost-recovery rate was only 67%.

8.9 The ORO had not established a long-term cost-recovery strategy. According to the Executive Council Memorandum of June 1987, the Administration intended to review the fees in two years' time. Audit noted that the major revenue items of the ORO (see paragraph 8.1 above) had so far not been revised. The petitioner's deposit and the minimum fee had not been adjusted for 11 years since 1985. Furthermore, for a time the Administration was unable to determine whether the cost of services provided by the ORO should be fully recovered. In February 1996, the FB advised the ORO that a cost-recovery rate was important in providing a yardstick for measuring performance and a basis for the annual fee revision. It was only in October 1999 that the Administration accepted a target cost-recovery rate of 60%.

8.10 As mentioned in paragraph 8.1 above, the major source of revenue of the ORO is the fees charged on the basis of a percentage of assets realised and distributed from an insolvent estate. However, this method of charging fees is not always equitable because the fees charged are not calculated on the basis of the time spent on administering each case and the relevant costs. There may be cases where the fees received (which were based on assets realised and distributed) exceed the costs of administering the insolvency cases. There may also be cases where fees received are less than the related costs despite the fact that there are available assets in the insolvent estate. An audit review of the cases handled by the ORO from its establishment in June 1992 to March 1999 indicated that, due to the small amount of assets realised and distributed, the ORO in general under-recovered its operating costs, except for some very large insolvency cases with exceptionally large amounts of assets realised and distributed. **Under the existing legislation, except for those cases where the Official Receiver is the provisional liquidator, the ORO cannot charge fees on a full time-cost recovery basis. Audit estimated that \$103 million of the operating deficit could have been recovered from those estates with available assets had amendments to the present legislation been made to enable the charging of fees based on the costs of insolvency administration** (see the first inset of paragraph 8.14 below and Appendix E).

Note 9: *Full cost includes cash costs (such as salaries, allowances and departmental expenses) and non-cash costs (such as staff oncost, central administrative overheads and depreciation).*

8.11 Collection of the minimum fee through the petitioner's deposit is a major source of revenue of the ORO (see the first inset of paragraph 8.1 above). However, the ORO was unable to revise the minimum fee annually, as intended by the former Registrar General, in order to maintain its real value against inflation. As it turned out, the ORO raised the minimum fee by 12.5% in 1996 and 8% in 1997. While there were discussions within the ORO on proposals to raise the minimum fee and the petitioner's deposit to recover full costs, it did not put up such proposals to the Government Secretariat amid concerns that it might not be acceptable to the Legislative Council. The ORO estimated that had such proposals been implemented, it would have been able to reduce its annual deficit by \$23 million. In Audit's view, in view of the significant financial implications, the justifications for these fee revision proposals should have been properly drawn up and submitted to the Legislative Council for consideration.

8.12 There are anomalies under the existing system of charging of fees by the ORO. For debts of an insolvent estate collected by the ORO, it can only charge fees based on the assets realised to cover the collection cost. For the same insolvent estate, if the ORO engages the debt collection agent to collect the book debts, the ORO can obtain reimbursement for the agency fees from the estate in addition to the realisation fee. In effect, by using the collection agent, the ORO can achieve significant savings in its staff resources by charging the costs of the agent to the estate. Audit considers that there is a need for the ORO to address this anomaly given the frequent use of the debt collection agent by the ORO. **In Audit's view, the adoption of the full cost of insolvency administration as a basis for determining the fees to be charged by the ORO provides a more reasonable and equitable approach to tackling the cost-recovery problem in insolvency administration.**

8.13 Audit notes that PIP who handle insolvency cases either in the capacity as liquidators or as agents for the ORO charge the estates on the basis of full-cost recovery for the services rendered plus their profits. Moreover, where the ORO is required to act as provisional liquidator, the ORO also charges the insolvent estate its full cost of the provisional liquidation work (see the second inset of paragraph 2.20 above).

8.14 If the full cost of insolvency administration is to be used as the basis for determining the fees to be charged by the ORO, it would appear that the following steps should be taken:

- the distribution and realisation fees charged by the ORO on assets realised and dividends distributed should be abolished. Instead, the full cost of insolvency administration has to be recovered from the available assets of individual estates. **The law may have to be amended;**
- the ORO needs to develop a job costing system to produce full-cost records for individual insolvency case (excluding the cost of the ORO's law enforcement work relating to insolvency offences). Detailed time records have to be maintained on work done by the staff of the ORO; and
- a pre-determined target cost-recovery rate should be set. A provision has to be made in the law to waive the fees in case the available funds of the insolvent estate are insufficient to meet the insolvency costs.

8.15 The proposed approach supports the Secretary for the Treasury's urge for the ORO to exercise strict cost control. By keeping detailed time records and costing on its activities, the ORO can establish cost norms which enable it to identify insolvency cases or activities which are particularly costly, and to identify those procedures and activities that require simplification or re-engineering. Under the existing procedures, the fee income depends on the value of assets realised and distributed. It is difficult for the ORO to ascertain whether the fee received can achieve the target cost-recovery rate. Under the full-cost approach, as the fee income is based on a pre-determined cost-recovery rate, the Government's subsidy can be properly defined.

Audit recommendations on fees charged by the ORO

8.16 **Audit has recommended that the Official Receiver should:**

- **critically review the effectiveness of the ORO's existing fees structure and consider setting up a proper system of recovering the costs of insolvency administration; and**
- **consider introducing a job costing system to better monitor and control the costs incurred in insolvency administration with a view to reducing the need to increase fees.**

8.17 **Audit has also recommended that the Official Receiver should, in consultation with the Secretary for Financial Services and the Secretary for the Treasury:**

- **regularly review the target cost-recovery rate of the ORO having regard to the prevailing economic climate and submit fee proposals accordingly in order to achieve the target cost-recovery rate; and**
- **critically consider the feasibility of charging insolvency fees on the basis of the full cost of insolvency administration.**

Response from the Administration

8.18 The **Secretary for Financial Services** has said that he believes that the present role and functions of the Official Receiver warrant a fundamental review. He has also said that:

- he is fully aware that as Hong Kong's economy has become highly service-oriented and an average company nowadays does not necessarily need to have much tangible capital asset for production, it is likely that the trend of increase in both the number and proportion of "non-remunerative" cases will continue. This phenomenon explains why the ORO has been operating with an increasing annual deficit;
- there is a limit to which the fees for the petitioning creditor or the petitioning bankrupt can be increased because an unproportionately high petitioning fee will deter or

discourage petitioners from having access to the insolvency service and depriving them of their rights under the relevant law. This raises the even more fundamental issue of whether the Government should accept virtually unlimited responsibility to subsidise any commercial activity, including insolvencies; and

- the Administration needs to examine critically what role the Government should play in insolvency service and to explore how the expertise in the private sector may be more fully utilised. Towards this end, the Financial Services Bureau and the ORO will jointly commission a consultancy study to examine how to reform the ORO to ensure that on the one hand, insolvency service can continue to be provided at an acceptable commercial and professional standard while on the other hand, insolvency service will not become an unlimited commitment at the expense of the taxpayer.

8.19 The **Secretary for the Treasury** has said that she agrees generally with the audit recommendations. She will support the Financial Services Bureau and the ORO in reviewing the overall cost-recovery level of ORO fees regularly, taking into account the audit recommendations, changing economic situations, and development of saving measures adopted in the ORO. She has also said that the FB has in the past few years regularly requested the ORO to conduct a comprehensive review of its fee structure and streamline procedures with a view to improving the cost-recovery ratio, having regard to acceptability to the public and the Legislative Council. Subsequent to the advice given in February 1996, she further advised the ORO in January 1997 and August 1998 to explore the feasibility of increasing the minimum fee and the possibility of making legislative amendments to simplify procedures.

8.20 The **Official Receiver** has said that:

- with regard to the audit observation on cost-recovery rate mentioned in paragraph 8.4 above, the ORO was able to achieve full recovery of costs from 1986-87 to 1993-94 because the ORO had quite a number of liquidation cases with sizeable realisations. However, since 1994-95, he has not been liquidators of many remunerative cases because such cases were few and the Panel A Scheme was introduced in 1996; and
- with regard to the audit observation on the revisions of the minimum fee mentioned in paragraph 8.11 above, the annual inflation figures were generally adopted for fee revisions for most fees and charges during that period.

Expenditure and disbursements approved by the ORO

8.21 Under the Bankruptcy Ordinance and the Companies Ordinance, the ORO is responsible for approving the payment of expenditure and disbursements on behalf of insolvent estates. Audit has reviewed the cost control measures in the ORO for giving such approvals. The audit revealed that there were incidents which indicated that the ORO did not pay due regard to economy in the course of administering the insolvent estates. The audit findings are described in paragraphs 8.22 to 8.26 below.

Audit observations on expenditure and disbursements approved by the ORO

Land search conducted by the ORO

8.22 The ORO commences preliminary investigations upon receipt of the winding-up and receiving orders. These preliminary investigations include land searches in the Land Registry to find out if there are any properties registered in the name of the insolvent companies or the bankrupts. The land search fee is paid eventually from the insolvent estates to the Land Registry.

8.23 Since the provision of a direct on-line search facility to government departments by the Land Registry in April 1997, government departments have been able to make direct on-line searches of the computerised land registers and place orders for copies of land records using computers at their own offices. The search fee per name by on-line search was \$100 in April 1997 and was reduced to \$20 in August 1999. In comparison, in April 1997, the search fee for requesting the same information, by means of a memo to the Land Registry, was \$160 per name (Note 10). Moreover, on-line enquiry also shortens the search time by about 14 days.

8.24 Because of the perceived benefits of using direct on-line search facility, the IOs of the ORO were advised to use the direct on-line search facility when conducting land searches. Training sessions for the operation of the direct on-line search were also provided to all staff in March 1997. However, Audit noted that the ORO did not make use of the direct on-line search facility. Since the introduction of the on-line search function, all land searches by owner's name were still arranged by sending memoranda to the Land Registry. According to the ORO, the use of direct on-line search would cause inconvenience to its staff because, instead of issuing memoranda to the nine land registries concerned, the ORO staff had to conduct nine separate searches of the computer records of the nine land registries. However, in Audit's view, issuing memoranda to the Land Registry not only lengthens the time needed to obtain the required information but also increases the cost per enquiry (see Note 10 in paragraph 8.23 above). In September 1999, following the significant decrease in the on-line search fee to \$20, the ORO issued a technical circular to the case IOs that all land searches should be conducted through the on-line search in view of the cost savings. Audit estimated that a total of \$1.8 million of search fees charged to insolvent estates, during the period April 1997 to August 1999, was nugatory.

Note 10: *The search fees are as follows:*

<i>Period</i>	<i>On-line search fee</i>	<i>Manual search fee</i>	<i>Difference</i>
	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
<i>1 April 1997 – 31 May 1997</i>	<i>100</i>	<i>160</i>	<i>60</i>
<i>1 June 1997 – 31 May 1998</i>	<i>110</i>	<i>170</i>	<i>60</i>
<i>1 June 1998 – 29 August 1999</i>	<i>120</i>	<i>185</i>	<i>65</i>
<i>On or after 30 August 1999</i>	<i>20</i>	<i>185</i>	<i>165</i>

Expenses for overseas duty visit

8.25 An audit scrutiny of the travelling expenses charged to the Companies Liquidation Account for the past financial years revealed an incident of overseas travel expenditure incurred by a senior ORO officer. In April 1997, the ORO officer accompanied a private counsel engaged by the ORO to New York in connection with the litigation work of an insolvency case. The expenses of the overseas trip for the ORO officer and the private counsel, including air passages and hotel charges, amounted to \$115,732 during the period 10 to 18 April 1997. The expenses were charged to the estate of the insolvency case concerned. The expenses attributable to the ORO officer were \$59,744, including hotel charges of \$25,088.

8.26 Audit noted that the ORO had not issued specific guidelines on the procedures to be followed for claiming overseas duty travel expenses. However, according to the Civil Service Regulations, a government officer on duty outside Hong Kong may be granted a subsistence allowance which is intended to cover the cost of the appropriate standard of accommodation and meals, laundry charges, casual entertainment, gratuities, travelling expenses within towns and all minor incidental out-of-pocket expenses. In this particular case, instead of \$25,088, the ORO officer should have only been entitled to a subsistence allowance of \$12,542 under the Civil Service Regulations. Audit also noted that in claiming for the reimbursement of the expenses of overseas duty visit, the relevant payments were only authorised by the ORO officer himself. Audit considers that, from the internal control point of view, the existing payment procedures and controls were deficient.

Audit recommendations on expenditure and disbursements approved by the ORO

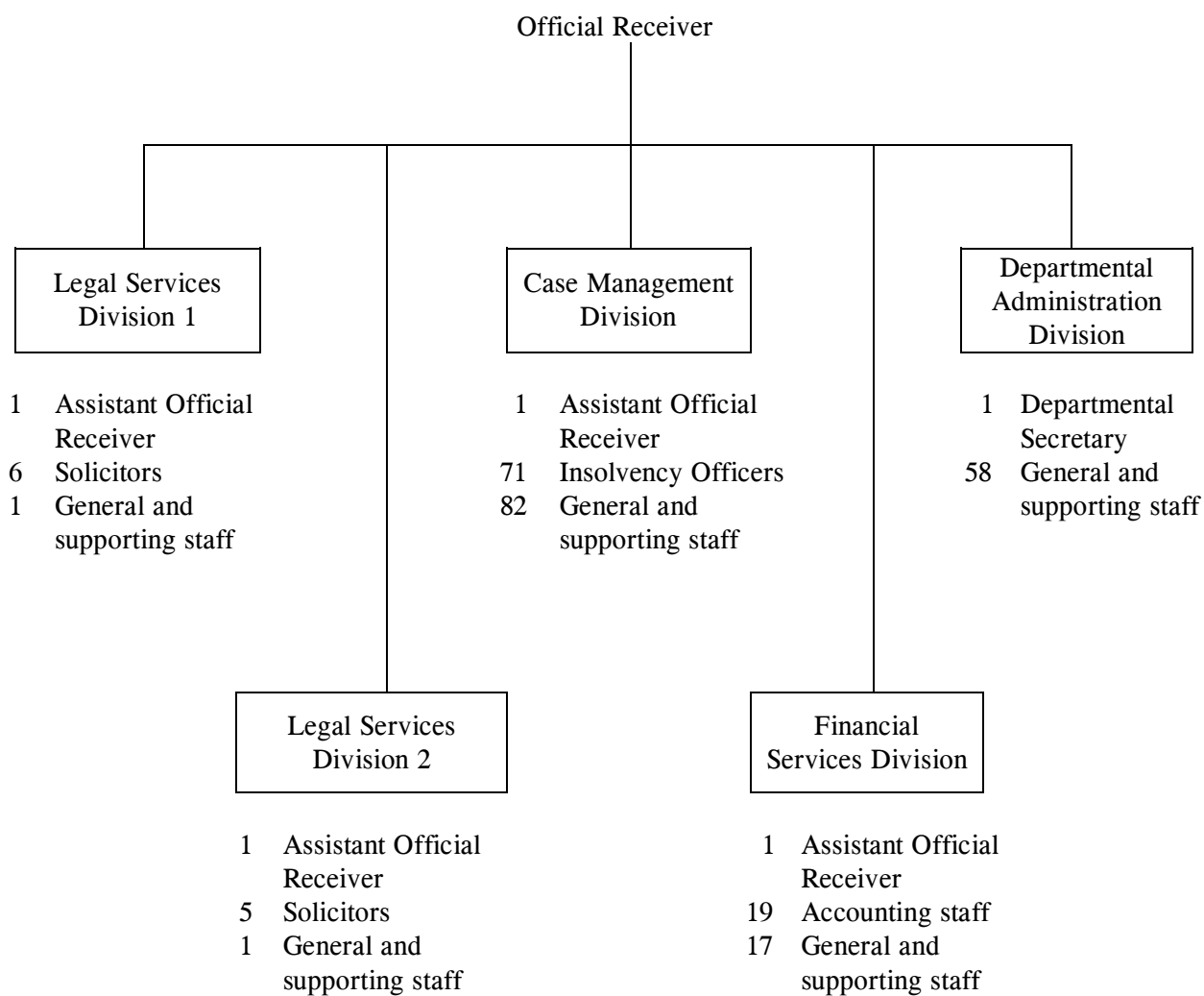
8.27 Audit has *recommended* that the Official Receiver should remind all the IOs of the importance of exercising proper controls and the need to continuously explore ways of reducing the expenditure to be charged to insolvent estates. In particular, the Official Receiver should:

- issue guidelines for ORO staff to economise on the use of the estates' funds in administering insolvency matters and introduce proper procedures for the approval of payments; and
- adopt a fair and reasonable method for charging expenditure to insolvent estates to ensure that funds are spent economically and costs are charged equitably (e.g. the duty travel expenses should not exceed the usual entitlement of government officers).

Response from the Administration

8.28 The **Official Receiver** has said that he agrees with the audit recommendations on the expenditure and disbursements approved by the ORO.

Organisation chart of the ORO as at 1 November 1999



Source: ORO's records

Note: As at 1 November 1999, there were 266 staff in the ORO.

Audit observations on distribution of realised assets

Case 1 (Cash balance as at 30 September 1999: \$1.05 million)

1. In March 1992, all the known assets of this insolvent estate were realised and the collection of book debts was completed. There were no other outstanding matters except the distribution of dividends to the ordinary creditors. Audit noted that 55 claims were lodged by ordinary creditors before 1987. However, the adjudication of the claims did not take place until August 1995.

2. From August 1995 to December 1995, the ORO sent letters to 18 of the 55 creditors requesting them to provide additional information to substantiate their claims. Only one creditor was able to comply with the request. The other creditors could not be located or were unable to supply additional information due to the long passage of time. Audit noted that apart from sending letters to the creditors, the ORO did not adjudicate the claims and distribute dividends to the creditors. According to the case IO in charge, due to limited staff resources, priority was given to other more urgent cases and no further action was taken on this case.

Case 2 (Cash balance as at 30 September 1999: \$1.06 million)

3. In May 1986, a full repayment of \$0.3 million to the preferential creditors was made. So far, the ordinary creditors had made 69 claims for about \$49 million. According to the ORO, this case was ready for the distribution of first dividend in October 1989. However, there was no adjudication of the claims up to the time of audit review in September 1999. According to the case IO in charge, due to limited staff resources, priority was given to other more urgent cases.

4. In response to creditors' enquiries about the status of the adjudication, the ORO informed them in May 1994, July 1995 and February 1997 that adjudication of claims was still in progress. Audit noted that up to September 1999, the adjudication of claims had not commenced.

Case 3 (Cash balance as at 30 September 1999: \$3.26 million)

5. In January 1991, the ORO decided that this case should be ready for the distribution of preferential payment and dividend as the cash held was over \$2 million. However, the adjudication of the preferential creditors' claims did not start until October 1996. The first and final preferential payment of \$28,630 was declared in February 1998.

6. There was no adjudication of the claims of the ordinary creditors for the distribution of dividends. According to the case IO in charge, the delay of distribution of dividends was due to the fact that the adjudication of claims for this case, where the insolvent company was an insurance company, was more complex. However, Audit noted that the ORO did not take any action to adjudicate the creditors' claims although this case was ready for distribution of dividends in January 1991.

Case 4 (Cash balance as at 30 September 1999: \$12.95 million)

7. Realisation of assets and distribution of dividends to creditors were completed in January 1996. However, up to September 1999, the ORO did not pay the surplus funds to the 78 shareholders. According to the case IO in charge, it would take time to pay surplus funds to the shareholders. Due to limited staff resources, priority was given to other more urgent cases.

Appendix C
(paragraph 5.1 refers)

**Performance targets and actual achievements of the ORO
in 1993-94 and 1998-99**

Service	Target response time	Percentage achieved in 1993-94 (Note 1)	Percentage achieved in 1998-99	Improvement over 1993-94
		(a)	(b)	(c) = $\frac{(b) - (a)}{(a)} \times 100\%$
General enquiries:				
In person	10 minutes	92.4 %	93.6 %	1.3 %
By mail	Within 10 days	(Note 2)	(Note 2)	N.A.
Bankruptcy and winding-up searches:				
In person	1 working day	87.7 %	96.0 %	9.5 %
By mail	3 working days	100 %	100 %	—
Application for certificate of non-bankruptcy	3 working days	100 %	100 %	—
Lodging proofs of debt:				
In person	5-10 minutes	99.1 %	95.1 %	(4.0 %)
Obtaining assistance of officers	15-30 minutes	99.9 %	99.2 %	(0.7 %)
Request for copies of statement of affairs	3 working days	100 %	100 %	—
Collection of dividends:				
In person	20-40 minutes	99.9 %	(Note 2)	N.A.
By mail	5 working days	100 %	100 %	—
Holding meetings of creditors:				
(a) Winding-up and old bankruptcy cases:				
Decision to hold meetings				
Holding meetings	Within 8 weeks	(Note 3)	70.6 %	N.A.
(b) New bankruptcy cases:	Within 12 weeks	(Note 3)	78.8 %	N.A.
Decision to hold meetings				
Holding meetings	Within 12 weeks	(Note 3)	100 %	N.A.
	Within 16 weeks	(Note 3)	100 %	N.A.
Issue of receipts for payment of book debts:				
In person				
By mail	15 minutes	(Note 3)	100 %	N.A.
	3 working days	(Note 3)	98.2 %	N.A.
Process written fund withdrawal requests from PIP as liquidators				
(a) Pool Investment Scheme				
(b) Funds invested separately	3-10 working days	(Note 3)	96.8 %	N.A.
	2 working days	(Note 3)	100 %	N.A.
Processing invoices and arranging payments to vendors	Within 30 calendar days upon receipt of invoice/service	(Note 3)	95.4 %	N.A.

Source: Annual Estimates and ORO's annual departmental reports

Note 1: The ORO's performance targets were first introduced in December 1993. The percentages achieved in 1993-94 were for the period from 1 December 1993 to 31 March 1994.

Note 2: There were no such services in the year.

Note 3: There were no such performance targets in 1993-94.

Appendix D
(paragraph 5.1 refers)

**Performance indicators of the ORO
in 1993-94 and 1998-99**

Performance indicator	1993-94	1998-99	Percentage increase/(decrease) over 1993-94
	(a)	(b)	(c) = $\frac{(b) - (a)}{(a)} \cdot 100\%$
Total number of new cases	751	1,942	158.6 %
Number of active outstanding cases at year end	2,101	4,017	91.2 %
Number of cases completed, stayed or rescinded	731	919	25.7 %
Cases put on release programme	378	259	(31.5 %)
Cases put on small case programme	196	657	235.2 %
Number of proofs of claim adjudicated	4,057	2,439	(39.9 %)
Number of cases with dividends declared	259	181	(30.1 %)
Amount of dividends declared (\$ million)	82	55	(32.9 %)
Recovery of book debts (\$ million)	34	19	(44.1 %)
Litigation actions in progress	57	41	(28.1 %)
Warrants of arrest executed	22	3	(86.4 %)
Number of summonses issued	101	162	60.4 %
Court appearances	1,630	3,532	116.7 %
Ex-parte orders obtained	2,034	3,168	55.8 %
Revenue collected (\$ million)	80	126	57.5 %
Actual expenditure (\$ million)	62	114	83.9 %
Cost-recovery rate	113 %	52 %	(54.0 %)

Source: Annual Estimates and ORO's annual departmental reports

Appendix E
(paragraph 8.10 refers)

**Total amount of cost under-recovered from estates
for the period 1 June 1992 to 31 March 1999**

Insolvency case	Number of cases	Estimated fees based on costs of insolvency administration (Note 1) (\$ million)	Estimated fees based on fee scale (Note 2) (\$ million)	Additional fees recoverable (Note 3) (\$ million)
Active bankruptcy cases with assets				
Not exceeding \$50,000	1,458	92.8	1.5	2.6
Over \$50,000 – \$200,000	214	34.6	3.0	14.2
Over \$200,000	99	20.8	11.3	9.5
Completed bankruptcy cases with assets				
Not exceeding \$50,000	1,684	107.2	1.1	1.5
Over \$50,000 – \$200,000	79	12.8	1.1	4.9
Over \$200,000	67	14.0	5.6	8.4
Active winding-up cases with assets				
Not exceeding \$50,000	1,058	67.4	1.3	2.4
Over \$50,000 – \$200,000	258	41.7	3.9	18.3
Over \$200,000	183	38.4	24.6	13.8
Completed winding-up cases with assets				
Not exceeding \$50,000	1,364	86.9	1.4	2.3
Over \$50,000 – \$200,000	218	35.2	3.0	14.0
Over \$200,000	118	24.7	14.0	10.7
Total	<u>6,800</u>	<u>576.5</u>	<u>71.8</u>	<u>102.6</u>

Source: Audit's analysis of ORO's records

Note 1: The estimated costs were based on the following time-cost estimates made by the ORO in July 1999:

- \$63,682 for insolvency cases with assets not exceeding \$50,000; and
- \$161,454 for insolvency cases with assets between \$50,000 and \$200,000.

In the absence of an ORO time-cost estimate for insolvency cases with assets exceeding \$200,000, Audit used \$209,890 (being 30% higher than the time-cost estimate for cases with assets between \$50,000 and \$200,000) as the estimated cost for such cases.

Note 2: The fees for the administration of insolvency cases are 10% on assets realised and 5% for dividends distributed.

Note 3: Additional fees recoverable are equal to the difference between the estimated fees based on time costs and the estimated fees based on fee scale. However, the maximum amount of fees recoverable cannot exceed the available balances of the insolvent estates.

Acronyms and abbreviations

CIO	Chief Insolvency Officer
CMD	Case Management Division
CSTDI	Civil Service Training and Development Institute
FB	Finance Bureau
FSD	Financial Services Division
IO	Insolvency Officer
ORO	Official Receiver's Office
PIP	Private insolvency practitioners