

## **CHAPTER 5**

### **Official Receiver's Office**

<h4><b>Provision of insolvency services</b></h4>
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**Audit Commission  
Hong Kong  
28 March 2012**

*This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.*

Report No. 58 of the Director of Audit contains 8 Chapters which are available on our website at <http://www.aud.gov.hk>.

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# PROVISION OF INSOLVENCY SERVICES

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## **PART 1: INTRODUCTION**

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

### **Background**

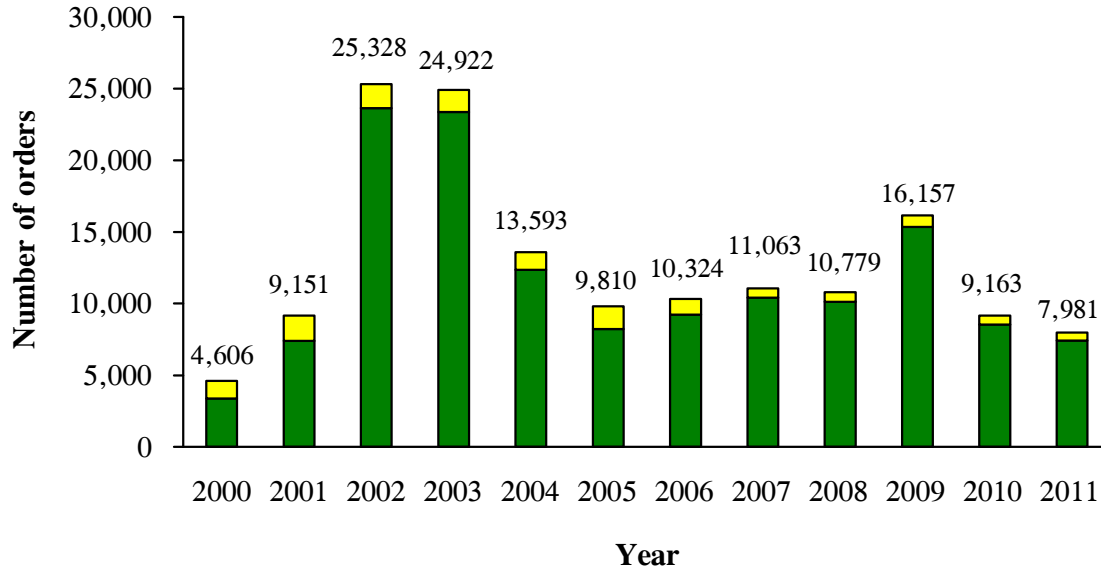
1.2 *Bankruptcy of insolvent individuals.* According to the Bankruptcy Ordinance (Cap. 6), where an individual (or a firm of individuals in partnership) is unable to pay his debts, he or his creditors (Note 1) may present a petition to the court for a bankruptcy order against him (a procedural flowchart is at Appendix A). An alternative to bankruptcy is an individual voluntary arrangement. This requires the individual to make a repayment proposal. On approval at a creditors' meeting, the individual voluntary arrangement is binding on all creditors. Figures 1 and 2 show the number of bankruptcy orders made by the court and approved individual voluntary arrangements registered by the **Official Receiver's Office (ORO)** in the past 12 years from 2000 to 2011. As at 31 December 2011, there were 27,135 active bankruptcy cases (majority being debtor-petitioned cases) and 7,409 active individual voluntary arrangement cases.

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**Note 1:** *A creditor who is owed \$10,000 or more may petition for a bankruptcy order, i.e. a creditor-petitioned case. When the petition is presented by an individual who is unable to pay his debts, it is known as a debtor-petitioned case.*

Figure 1

Number of bankruptcy orders made  
(2000 to 2011)

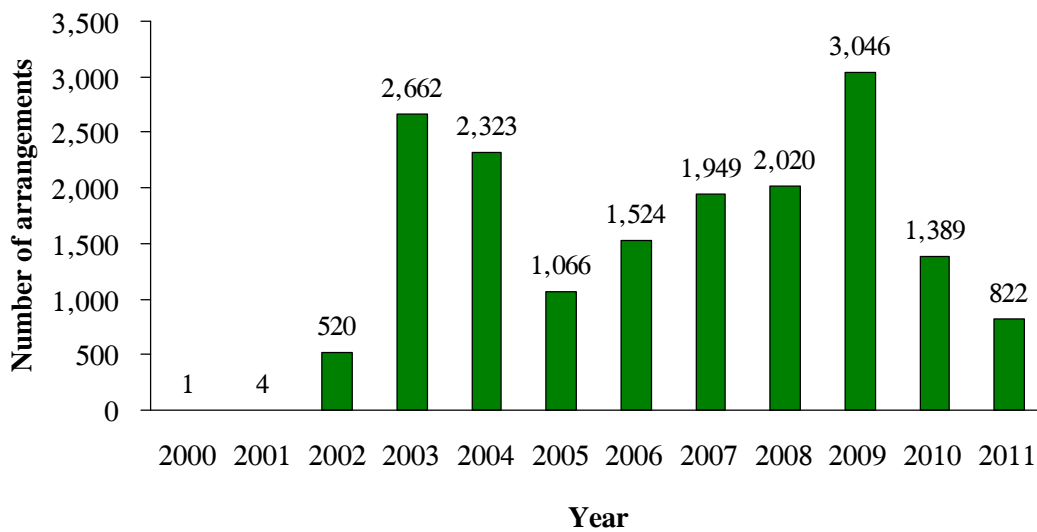


Legend: ■ Debtor-petitioned cases  
■ Creditor-petitioned cases

Source: ORO records

Figure 2

Number of individual voluntary arrangements registered  
(2000 to 2011)

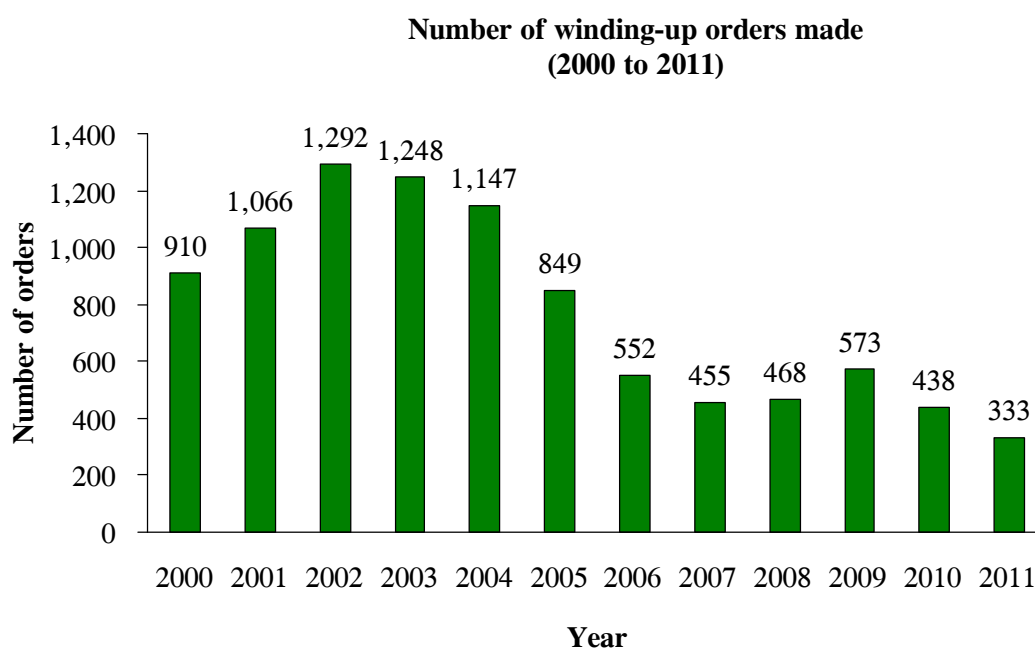


Source: ORO records



1.3 **Compulsory winding-up of insolvent companies.** The Companies Ordinance (Cap. 32) provides that a company may be wound up compulsorily by the court if it is unable to pay its debts (Note 2). A petition to the court for a winding-up order against the company shall be presented by the company or its creditors (a procedural flowchart is at Appendix B). Figure 3 shows the number of winding-up orders made in the past 12 years from 2000 to 2011. As at 31 December 2011, there were 2,375 active winding-up cases.

Figure 3



Source: ORO records

1.4 **Insolvency services.** The ORO is responsible for providing the following major insolvency services:

- (a) in-house management of insolvency cases when the Official Receiver acts as the trustee (for bankruptcy cases) or liquidator (for compulsory winding-up cases). The work includes realisation of assets, adjudication of creditors' claims and distribution of dividends;
- (b) management of the schemes for outsourcing bankruptcy cases and compulsory winding-up cases to private insolvency practitioners (PIPs); and

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**Note 2:** *The Companies Ordinance also provides for the voluntary winding-up of a company. The scope of this audit does not cover such voluntary winding-up cases as they are not administered by the ORO (see para. 1.4).*

- (c) administration of matters relating to individual voluntary arrangements in accordance with the Bankruptcy Ordinance, including the maintenance of a register of individual voluntary arrangements for public inspection.

As at 31 December 2011, the ORO had an establishment of 225 staff organised into five divisions (see the organisation chart at Appendix C). Its estimated expenditure for 2011-12 was \$136 million.

### **The 2000 audit**

1.5 In 2000, the Audit Commission (Audit) completed an audit review of the services provided by the ORO. The results were included in Chapter 5 of the Director of Audit's Report No. 34 of February 2000, and were examined by the Public Accounts Committee (PAC) of the Legislative Council. In its Report No. 34 of June 2000, the PAC made a number of recommendations for improvement in various areas. Annually, the Administration submitted progress reports on its implementation of the PAC's recommendations. The position as at October 2011 is summarised as follows:

- (a) the ORO had conducted a comprehensive review of the practices and procedures in the administration of insolvency cases. In addition, a consultant commissioned by the Administration had conducted a review of the role of the ORO in the provision of insolvency services (the 2002 consultancy study). Based on the results of the two reviews, the ORO had introduced improvement measures in all the areas of concern, except for the fees charged by the ORO; and
- (b) the ORO had started to review its cost of operation and the issues of fees and cost recovery rates after implementing a pilot scheme in May 2008 to outsource bankruptcy cases to PIPs.

In its Report of February 2012, the PAC noted that the ORO had been reviewing the level of its fees and charges and would consult the Legislative Council Panel on Financial Affairs, and wished to be kept informed of further development on the subject.

### **Audit review**

1.6 Audit has recently conducted another review of the ORO's provision of insolvency services to follow up the issues examined in the 2000 audit and examine new developments (such as the outsourcing of bankruptcy cases as recommended by the 2002 consultancy study — see para. 1.5(a) and (b)) to ascertain whether there are further areas with room for improvement. The review has focused on the following areas:

- (a) in-house management of insolvency cases (PART 2);
- (b) outsourcing of insolvency cases (PART 3);
- (c) fees and charges (PART 4); and
- (d) individual voluntary arrangement (PART 5).

Audit has found room for improvement in the above areas and has made a number of recommendations to address the issues.

### **Acknowledgement**

1.7 Audit would like to acknowledge with gratitude the full cooperation of the staff of the ORO during the course of the audit review.

## **PART 2: IN-HOUSE MANAGEMENT OF INSOLVENCY CASES**

2.1 This PART examines the ORO's in-house management of insolvency cases. The following issues are discussed:

- (a) summary procedures for small insolvency cases (paras. 2.3 to 2.7);
- (b) asset search and realisation (paras. 2.8 to 2.14);
- (c) investigation of bankruptcy offence and misconduct (paras. 2.15 to 2.19);
- (d) quality management assessment (paras. 2.20 to 2.26); and
- (e) unreleased insolvency cases (paras. 2.27 to 2.32).

### **Insolvency casework**

2.2 The ORO handles insolvency casework when the Official Receiver is appointed as the liquidator or trustee by the court or creditors. Through two outsourcing schemes (see para. 3.2(a) and (b)), the ORO has contracted out most of its winding-up cases. As regards bankruptcy cases, the Bankruptcy Ordinance provides that the ORO may outsource the debtor-petitioned summary cases (i.e. those with realisable assets within \$200,000 where summary procedures apply — para. 2.3). As at 31 December 2011, the ORO was working on 7,744 active bankruptcy cases, 26,844 undischarged bankruptcy cases and 199 active winding-up cases (with most of the winding-up cases carried forward from previous years).

### **Summary procedures for small insolvency cases**

2.3 Both the Bankruptcy Ordinance and Companies Ordinance have provisions for applying summary procedures to small insolvency cases, as follows:

- (a) when the realisable assets of a bankruptcy or winding-up case are unlikely to exceed \$200,000, the court may (upon application by the provisional trustee or provisional liquidator) order that the cases can be administered in a summary manner; and
- (b) thereupon, the provisions of the Ordinances shall apply subject to the following modifications:

- (i) the first meeting of creditors shall be dispensed with, and the provisional trustee or provisional liquidator (usually the Official Receiver) shall become the trustee or liquidator;
- (ii) there shall be no creditors' committee or committee of inspection, and the trustee or liquidator may do all the things which would otherwise require the permission of these committees; and
- (iii) such other modifications as may be prescribed with a view to saving expense and simplifying procedures.

### **Audit observations and recommendation**

2.4 In 1976 when the Bankruptcy Ordinance and Companies Ordinance were amended to lay down summary procedures for small insolvency cases, the limit for their application was set at \$10,000. In 1985, the limit was increased to the present level of \$200,000. In May 1985, the Legislative Council was informed that the increase was to enable the ORO to use summary procedures in a greater number of cases and so reduce its workload.

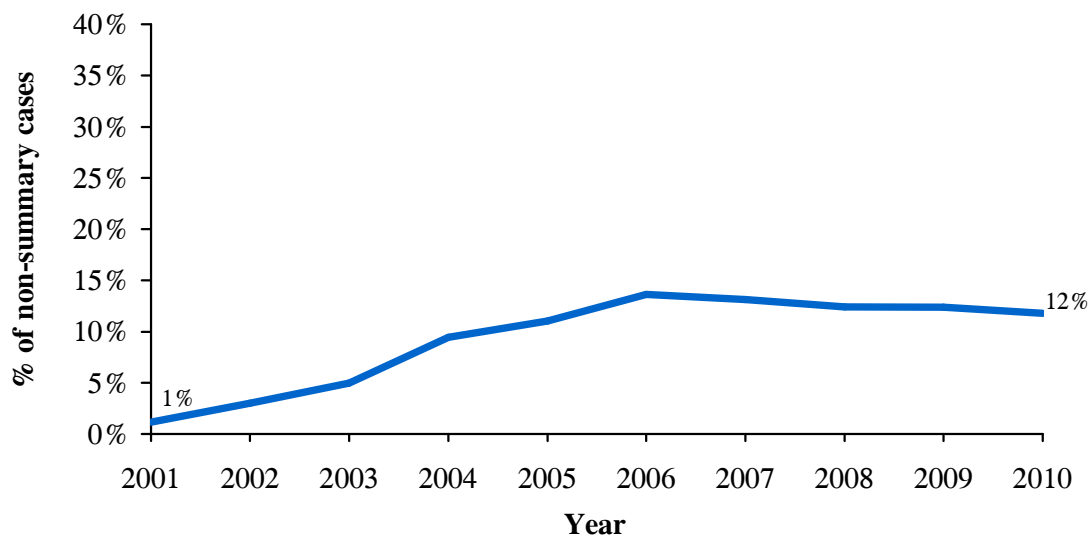
2.5 Audit noted that, over the past 10 years, the number of non-summary cases (Note 3) had increased from 117 (1% of all insolvency cases) in 2001 to 1,131 (12%) in 2010 (see Figure 4). With the lapse of 27 years since 1985, Audit considers it opportune for the ORO to review the current limit of \$200,000 for applying summary procedures to see if any revision is necessary in the light of changed circumstances, including the increase in the number of non-summary insolvency cases.

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**Note 3:** *Non-summary cases are cases for which summary procedures do not apply, i.e. those with assets exceeding \$200,000 or where meetings of creditors are convened upon request of the creditors.*

**Figure 4**

**Increase in percentage of non-summary cases  
(2001 to 2010)**



Source: ORO records

**Audit recommendation**

2.6 **Audit has recommended that the Official Receiver should review the limit of \$200,000 for applying summary procedures to see if any revision is necessary in the light of changed circumstances.**

**Response from the Administration**

2.7 The **Official Receiver** agrees with the audit recommendation. She has said that:

- (a) the increase of the limit to the existing level of \$200,000 in 1985 was to enable the ORO to use summary procedures in a greater number of cases so as to reduce the workload of the ORO (see para. 2.4). Since then, there has been outsourcing of some bankruptcy cases and the vast majority of winding-up cases have been outsourced to PIPs under various schemes; and
- (b) in reviewing the limit, the ORO needs to strike a balance between enhancing the efficiency of the bankruptcy and winding-up proceedings and ensuring that the rights of creditors and other affected parties would not be undermined as a result.

## Asset search and realisation

2.8 The Case Management Division of the ORO is responsible for in-house management of insolvency cases. The ORO has issued procedural guidelines on processing these cases (such as search and realisation of assets, investigation of offence and misconduct) for its case officers to follow. Audit findings in this area, as reported in paragraphs 2.9 to 2.18, mainly focused on bankruptcy cases which formed the bulk of the ORO's casework (see para. 2.2).

2.9 After a bankruptcy order is made and the Official Receiver is appointed as the trustee, the ORO is required to search, take possession of and realise the bankrupt's assets. The ORO has issued guidelines for its case officers in this regard, summarised as follows:

- (a) **Bank accounts.** A standard letter should be sent to all members of the Hong Kong Association of Banks and the Deposit-Taking Companies Association, requesting them to close the bankrupt's accounts, remit any credit balance to the ORO and provide the ORO with transaction statements of the accounts for the preceding six months;
- (b) **Landed properties.** A land search should be arranged. The case officer should register a memorial of the bankruptcy order against any landed property owned by the bankrupt. If the property is not subject to any incumbrances, the case officer should arrange for its sale;
- (c) **Unexpired insurance policies.** The case officer should request the relevant insurance companies to terminate the bankrupt's insurance policies and return the unexpired portion of premium to the ORO. For the provident fund, the case officer should obtain a copy of the fund agreement from the bankrupt and seek legal views on the entitlement and interest of the ORO;
- (d) **Vehicles.** The case officer should request the Transport Department to freeze the transfer of ownership of the bankrupt's vehicle and arrange for its sale as soon as practicable; and
- (e) **Undervalued transactions.** Under the Bankruptcy Ordinance, the Official Receiver as the trustee may apply to the court to set aside an undervalued transaction entered into by the bankrupt within five years before the presentation of the petition if the bankrupt is insolvent at the time of transaction or becomes insolvent as a result of it. If the transaction is entered into less than two years before the presentation of the petition, the insolvency of the bankrupt does not have to be proved by the trustee.

2.10 Proceeds from the realisation of the bankrupt's assets shall be paid into a bank account held by the ORO in the name of the bankrupt's estate (the bankruptcy account). The ORO charges an asset realisation fee and ad valorem fee (see para. 4.2) on payment of the proceeds into the account.

## **Audit observations and recommendations**

### *Asset search*

2.11 Audit checked the asset searches conducted by the ORO's case officers for 10 selected bankruptcy cases (five debtor-petitioned cases and five creditor-petitioned cases) and found that there was room for improvement, as follows:

- (a) **Land search.** The ORO guidelines require a land search be conducted in the name of the bankrupt for all creditor-petitioned cases (Note 4). However, there is no similar requirement for debtor-petitioned cases. According to the ORO, it relies on the information in the sworn statement of affairs provided by the bankrupt for conducting an asset search for debtor-petitioned cases (Note 5). Such information may not yet be available at the time the ORO conducts an asset search for creditor-petitioned cases. For four of the five debtor-petitioned cases examined by Audit, the case officers conducted land searches based on the property addresses provided by the bankrupts. There was a risk that any bankrupts' undeclared properties could not be detected. As for the creditor-petitioned cases, the land searches only covered properties then owned by the bankrupts. There was a risk that previous undervalued transactions of other properties entered into by the bankrupts (see para. 2.9(e)) could not be detected. The ORO needs to lay down guidelines requiring the checking of undervalued property transactions of bankrupts on a risk basis; and

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**Note 4:** *The ORO makes use of the Owner's Properties Information Check service provided by the Land Registry to conduct the land search. The search options available include searching for properties registered under a person's name, current ownership information of a property and all transactions that have been registered against a property.*

**Note 5:** *For a debtor-petitioned case, the Bankruptcy Ordinance requires a debtor (i.e. the bankrupt) to submit at the time of petition, a sworn statement of affairs containing particulars of his assets and liabilities. For a creditor-petitioned case, the bankrupt is required to submit such statement within 21 days of the bankruptcy order made.*



- (b) ***Other types of asset search.*** The case officers mainly conducted a search of other types of assets (e.g. vehicle and provident fund) based on information provided by the bankrupt and other relevant parties. According to the ORO, the case officers would exercise professional judgement to decide whether additional searches are necessary to detect undeclared assets. Audit found that in three of the 10 cases examined, the case officers conducted additional searches. However, all these searches were related to vehicle and creditor-petitioned cases. The ORO needs to remind the case officers that their additional searches for undeclared assets should cover different types of assets and bankruptcy cases as far as practicable.

### ***Asset realisation***

2.12 In one of the 10 cases examined (Case 1), the ORO charged against the bankrupt's estate an asset realisation fee and ad valorem fee totalling \$2.3 million in accordance with the scale as prescribed in the Bankruptcy Ordinance. The bankrupt applied to the court for fee remission. The court ordered the ORO to refund to the bankrupt the charged fees except for a sum of \$70,000. Audit examined the case (as detailed below) and found that there was room for improvement in the ORO's handling of creditor-petitioned bankruptcy cases.

## Case 1

### Creditor-petitioned bankruptcy case

1. In June 2009, a creditor presented a bankruptcy petition against the debtor for an outstanding amount (including management fees) of about \$53,000. On 5 August 2009, the court made a bankruptcy order. The ORO, as the provisional trustee, conducted bank and land searches which revealed that:

- (a) the debtor was the registered owner of five properties, including the one with outstanding management fees, and that the creditor had a memorandum of charge registered against this property before the bankruptcy petition; and
- (b) the debtor had bank balances totalling \$15.77 million.

2. On 12 August 2009, the ORO registered a memorial of the bankruptcy petition against each of the five properties but did not realise them. In September and October 2009, two banks remitted the debtor's bank balances to the ORO, totalling \$15.77 million.

3. As the realised assets exceeded \$200,000, the ORO arranged a creditors' meeting in November 2009 (in accordance with the statutory requirements for non-summary cases) and became the trustee. In the same month, the creditor lodged a proof of debt claiming a total of \$91,170. On 9 December 2009, the bankrupt (i.e. the debtor) filed a statement of affairs claiming that he had total assets exceeding \$27 million and his only liability was the amount owed to the creditor.

4. On 16 December 2009, the bankrupt applied for annulment of the bankruptcy order on the grounds that the provable debts had been secured (under section 33(1)(b) of the Bankruptcy Ordinance). In January 2010, the bankrupt also applied for remission of the ORO fees of \$2.3 million which were chargeable based on the realised bank balances.

5. In February and July 2010, the High Court ordered the annulment of the bankruptcy order and remission of the ORO fees respectively. In August 2010, the ORO lodged an appeal against the remission order. In January 2011, the Court of Appeal ordered the remission of the ORO fees except for a sum of \$70,000.

#### *Audit comments*

6. The circumstances of this case were exceptional in that the debtor was bankrupted for a debt of \$91,170 when he subsequently claimed that his assets were worth more than \$27 million. In fact, the creditor in this case had a memorandum of charge registered against the debtor's property (i.e. the debt had been fully secured). In Audit's view, procedures should be put in place for reviewing the justification of

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bankruptcy action of a creditor-petitioned case where the ORO's asset searches show that the outstanding debt has been fully secured. In such cases, the Legal Services Division needs to be alerted as to what actions may be taken (e.g. applying to the court for annulment of the bankruptcy order).

7. In the light of this case, the ORO also needs to conduct a review to see whether there is room for improvement in the management of bankruptcy cases.

*Source: ORO records*

### *Audit recommendations*

#### 2.13 **Audit has recommended that the Official Receiver should:**

- (a) **strengthen searches for undeclared assets and previous undervalued transactions of bankrupts, including:**
  - (i) **implementing a risk-based programme for conducting a land search in the name of a bankrupt for debtor-petitioned cases;**
  - (ii) **requiring, on a risk basis, the conduct of land searches to cover both the properties currently owned by a bankrupt and transactions entered into by him before the bankruptcy petition; and**
  - (iii) **reminding the case officers that their additional searches for undeclared assets should cover different types of assets and bankruptcy cases as far as practicable;**
- (b) **lay down procedures for reviewing the justification of bankruptcy action of a creditor-petitioned case where the ORO's asset searches show that the outstanding debt has been fully secured; and**
- (c) **in the light of Case 1, conduct a review to see whether there is room for improvement in the management of bankruptcy cases.**

## Response from the Administration

2.14 The **Official Receiver** agrees with the audit recommendations. She has said that:

- (a) upon the making of a bankruptcy order, all assets of the bankrupt are vested in the ORO. It is the obligation of the bankrupt to disclose all of his assets and liabilities in the statement of affairs and the preliminary examination questionnaire (Note 6) and to face prosecution for non-disclosure. Steps are taken to secure easily accessible assets, such as cash found in bank or safe deposit box, shares, vehicles, machinery and landed properties. Where the ORO has reasons to suspect that the bankrupt has not disclosed all of his assets, further investigation and follow-up actions will be taken to ascertain the situation and, where justified, to secure the assets for the benefit of creditors;
- (b) in the light of the audit recommendations, the ORO will review existing guidelines with a view to fine tuning the relevant procedures, such as clearly setting out the risk factors (e.g. the bankrupt's background and his employment history) to be taken into account in deciding whether to make further enquiries such as conducting additional land searches and investigations into the affairs and assets of the bankrupt in so far as it is practicable; and
- (c) the circumstances leading to bankruptcy in Case 1 are extremely rare, and the ORO will conduct a review on whether there is room for improvement in the management of such cases in future. Pending the outcome of the review, the ORO has already enhanced procedures in dealing with secured debts, and reminded case officers of the requirement to refer to the Legal Services Division as early as possible for legal advice on actions to be taken with regard to cases with secured debts or sufficient assets to pay creditors and other relevant costs.

## Investigation of bankruptcy offence and misconduct

2.15 The ORO has a statutory duty to investigate a bankrupt's conduct and assist the Secretary for Justice in prosecuting any offence committed by the bankrupt. If in the course of investigation, the bankrupt's conduct is found to be unsatisfactory, the ORO as the trustee may apply to the court to suspend the discharge of the bankrupt. Otherwise, the bankrupt would be automatically discharged four years after the bankruptcy order if he is a first-time bankrupt or five years if he has been previously adjudged bankrupt. The ORO

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**Note 6:** *After the issue of a bankruptcy order, the ORO conducts a preliminary examination of the bankrupt using a standard questionnaire to obtain his personal and business information, details of his assets and liabilities and the reasons for his financial problems.*

has put in place a system to bring up bankruptcy cases nine months before the dates of automatic discharge of the bankrupts for review by case officers. Case officers are required to seek their supervisors' approval of their recommendations and refer any objection case to the Legal Services Division for action 10 weeks before the discharge date.

2.16 Upon detection of any possible breach of the law, the case officers are required to collect further evidence. If there is prima facie evidence of a breach, they are required to pass the case to the Legal Services Division for consideration of taking prosecution action. The ORO has issued a circular reminding the case officers that the limitation period for summary prosecution of a bankruptcy offence (Note 7) shall be within one year from the date of discovery of the offence and, in any case, within three years from the date of the offence. Examples of offences committed by a bankrupt include:

- (a) ***Gambling.*** A bankrupt shall be guilty of an offence if, having a business and an outstanding trade debt at the date of the bankruptcy order, he has within two years prior to the presentation of the bankruptcy petition materially increased the extent of his insolvency by gambling that is unconnected with his business (section 133(1)(a) of the Bankruptcy Ordinance);
- (b) ***Undischarged bankrupt acting as director.*** An undischarged bankrupt shall be guilty of an offence if he acts as a director of a company (section 156(1) of the Companies Ordinance); and
- (c) ***Removal of property.*** A bankrupt shall be guilty of an offence if, after the presentation of a bankruptcy petition by or against him or within 12 months before such presentation, he fraudulently removes any part of his property (Note 8) to the value of \$50 or upwards (section 129(1)(e) of the Bankruptcy Ordinance).

### **Audit observations and recommendations**

2.17 Audit selected 10 bankruptcy cases (see paras. 2.11 and 2.12) for examining the case officers' investigation and follow-up action, and found that there was room for improvement in three of them (Cases 2 to 4).

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**Note 7:** *Any offence under the Bankruptcy Ordinance may be dealt with summarily in a magistrates' court.*

**Note 8:** *According to the Bankruptcy Ordinance, a bankrupt's property includes his money and goods.*

## Case 2

### Delayed follow-up action on suspected offence (gambling)

1. In November 2005, a debtor who was unable to pay debts of about \$1.3 million filed a bankruptcy petition. On 3 January 2006, the court made a bankruptcy order.

2. **Gambling.** On 9 January 2006, the bankrupt submitted a preliminary examination questionnaire (see Note 6 to para. 2.14(a)) in which he indicated that:

- (a) within two years before the bankruptcy petition, he had lost \$2.5 million in gambling which led to the insolvency;
- (b) he had been running an educational service business before making the petition; and
- (c) he did not keep proper books and records for his business.

3. While there was prima facie evidence that the bankrupt's gambling would constitute a bankruptcy offence (see para. 2.16(a)), the case officer did not carry out further investigation. In November 2008, almost three years after the bankrupt submitted his preliminary examination questionnaire, a Chief Insolvency Officer conducted a review (under the quality management assessment — see para. 2.20) and instructed that the case be referred to the Legal Services Division for advice. In reply, the Legal Services Division said that:

- (a) prosecution actions against the offences of gambling and failure to keep proper accounts could not be taken because both offences were time-barred (see para. 2.16); and
- (b) the case officer on seeing the preliminary examination questionnaire should have conducted investigation and referred the case to the Legal Services Division much earlier.

4. In September 2009, the case officer obtained the Legal Services Division's advice that the evidence at hand was not enough to secure a decision of the court for a suspension of the bankrupt's automatic discharge (see para. 2.15).

#### ***Audit comments***

5. The ORO needs to step up monitoring the investigation work of case officers to ensure that timely action is taken against a suspected bankruptcy offence.

Source: ORO records

### Case 3

#### Delayed follow-up action on suspected offence (removal of property)

1. In January 2008, a debtor who was unable to pay debts of about \$542,000 filed a bankruptcy petition. On 12 February 2008, the court made a bankruptcy order. In March 2008, the case officer conducted a company search which indicated that the bankrupt had not resigned as a director of a company. After the case officer had issued a reminder and a warning letter to the bankrupt, he resigned as a director in June 2009. In July 2009, the case was referred to the Legal Services Division for advice. In reply, the Legal Services Division said that it would not be in the public interest to take prosecution action as the bankrupt had resigned.

2. **Removal of property.** In reviewing this case, the Legal Services Division noted that in May 2008 the case officer discovered that the bankrupt received a sum of \$195,000, being the accrued benefit in his Mandatory Provident Fund account, in October 2007. The bankrupt could not provide supporting documents on how the money was spent. In September 2008, the case officer further found that the bankrupt held a bank deposit of \$103,000 in August 2007 but again could not provide supporting documents on how the money was spent. In November 2009, the Legal Services Division advised that the two removals of property warranted further investigation (see para. 2.16(c)) if the prosecution action was not time-barred.

3. **Objection to discharge of the bankrupt.** In December 2011, the case officer referred the case to the Legal Services Division for consideration of raising an objection to the automatic discharge of the bankrupt (see para. 2.15). In the same month, the ORO filed such an objection to the court on the grounds of unsatisfactory conduct of the bankrupt, viz:

- (a) he was suspected to have removed his provident fund of \$195,000 before presenting a bankruptcy petition; and
- (b) he was evasive and delayed in answering questions on the whereabouts of the money.

In February 2012, the court ordered the extension of the bankruptcy period by two years.

#### **Audit comments**

4. Similar to Case 2, there was again delay in referring this suspected case of bankruptcy offence to the Legal Services Division for consideration of taking prosecution action. Nevertheless, action was taken in time to raise an objection to the automatic discharge of the bankrupt on account of the bankrupt's unsatisfactory conduct.

Source: ORO records

## Case 4

### No action taken to object the discharge of a bankrupt

1. In September 2006, a debtor who was unable to pay debts of about \$112 million filed a bankruptcy petition. On 7 November 2006, the court made a bankruptcy order.

2. **Removal of provident fund.** Based on information provided by the bankrupt that she had withdrawn the balance in her Mandatory Provident Fund account, the case officer on 15 November 2006 enquired about its usage. In December 2006, the bankrupt replied that the money was spent on paying her business expenses but could not provide supporting documents. In January 2007, the case officer was informed by the insurance company that the provident fund of \$103,000 was withdrawn in April 2006. In November 2007, in response to the case officer's further enquiry, the bankrupt again said that she could not provide proof of usage of the provident fund.

3. **Removal of deposits.** In May 2010 (two and a half years later), the case officer resumed the enquiry. In June 2010, based on information provided by the bankrupt, the case officer asked the bank to provide the transaction history of the bankrupt. It was then revealed that the bankrupt had withdrawn deposits of \$191,000 in 2006. In response to the case officer's enquiry, the bankrupt said that, after the lapse of time, her recollection was that the money was used to pay salaries of her staff.

4. In June 2010, the case officer did not recommend any follow-up action on this case. In the event, the bankrupt was discharged in November 2010.

#### *Audit comments*

5. Similar to Case 3, the bankrupt in this case had removed properties twice before presenting her bankruptcy petition and failed to fully account for their usage. However, there was no documented reason why this case was not referred to the Legal Services Division for consideration of raising an objection to the discharge of the bankrupt. Moreover, there was a period of inaction of more than two years (from December 2007 to April 2010) before the case officer continued to press for more information from the bankrupt. In the event, the additional information led to the discovery of another suspected offence of removal of property. In Audit's view, the ORO needs to closely monitor the investigation work of the case officers to ensure that they follow through their investigation without delay and apply a consistent standard of enforcement against a bankrupt's misconduct.

Source: ORO records



### *Audit recommendations*

2.18 **Audit has recommended that the Official Receiver should step up the monitoring of investigation work to ensure that case officers:**

- (a) **take timely action against bankruptcy offences with due regard to the limitation period for summary prosecution;**
- (b) **follow through their investigations of suspected offences without delay;**
- (c) **apply a consistent standard in referring cases to the Legal Services Division for consideration of taking enforcement action against a bankrupt's misconduct; and**
- (d) **document the reasons for not raising an objection to the discharge of a bankrupt where there are indications that his conduct is unsatisfactory.**

### **Response from the Administration**

2.19 The **Official Receiver** agrees with the audit recommendations. She has said that the ORO:

- (a) has already reminded case officers of the time limitation for taking summary prosecution actions and the need to refer cases to the Legal Services Division in a timely manner. Arrangements have also been made to recirculate the guidelines to case officers on time limitation at regular intervals;
- (b) is exploring ways of stepping up supervision of investigation work carried out by case officers in cases where there are extraordinary circumstances requiring special attention; and
- (c) is reviewing the guidelines on raising an objection to the discharge of a bankrupt in a bid to streamline the decision-making procedures and to require case officers to document the reasons for not raising an objection for their supervisor's approval.

### **Quality management assessment**

2.20 In the 2000 audit review (see para. 1.5), Audit identified room for improvement in the ORO's monitoring of its staff workload. In October 2001, the ORO informed the PAC that since June 2001, it had put in place a quality management assessment whereby its Chief Insolvency Officers would conduct random checks of 5% of the insolvency cases handled by their staff. The purposes of the quality management assessment are to:

- (a) provide an independent mechanism for ensuring the quality of the services delivered; and
- (b) ensure that the guidelines and instructions are appropriately applied.

2.21 In a circular issued in June 2001, the ORO set out the detailed arrangements on the quality management assessment, summarised as follows:

- (a) the assessment would be conducted on a quarterly basis;
- (b) the overall number of cases to be selected for assessment per year would be 280 (based on 5% of the total number of insolvency cases with bankruptcy and winding-up orders made in the previous year); and
- (c) the cases to be assessed would be randomly selected from those that were nine months' old (counting from the dates of the respective court orders). They could be a mix of active and released insolvency cases.

2.22 In September 2002, having regard to the increase in insolvency cases, the ORO decided that each Chief Insolvency Officer would only check 12 insolvency cases every quarter. In October 2006, the ORO reduced the frequency of checks from a quarterly to a half-yearly basis. With five Chief Insolvency Officers deployed on performing such checks, the total number of cases checked would be 120 a year.

### **Audit observations and recommendations**

2.23 While the target number of quality management checks was reduced from 280 cases in 2001 to 120 cases from 2007 onwards, Audit found that from 2008 to 2010, the number of checks conducted each year fell short of the target. The shortfalls (totalling 95 cases) were eventually made good in 2011. In Audit's view, the ORO needs to step up efforts to ensure that the target number of checks a year is conducted in a timely manner.

2.24 Moreover, given the limited staff resources available for conducting quality management assessments, the ORO needs to ensure that they are used in a cost-effective manner, focusing on the high-risk cases. In this connection, Audit has noted that there is room for improvement in the ORO's method of selecting cases for checking, as follows:

- (a) according to the 2001 circular (still in force), the cases to be assessed should be randomly selected from those that are nine months' old (see para. 2.21(c)). Such a random selection approach could not ensure adequate coverage of the

high-risk cases. The ORO needs to adopt a risk-based approach in selecting cases, such as making reference to the previous checking results; and

- (b) given that the time limit for taking summary prosecution action against bankruptcy offences is one year after the detection of the offence, the selection of cases more than nine months' old for quality management checks is not appropriate. This is because some pursuable offences could be detected at too late a stage for taking timely prosecution action. An example is Case 2 in paragraph 2.17 in which a quality management check revealed that a suspected bankruptcy offence should be referred to the Legal Services Division for follow-up action. However, as the quality management check was conducted 34 months after the court order, the prosecution action was time-barred.

### *Audit recommendations*

#### 2.25 **Audit has recommended that the Official Receiver should:**

- (a) **step up efforts to ensure that the target number of quality management checks is conducted in a timely manner;**
- (b) **adopt a risk-based approach in selecting insolvency cases for quality management checks; and**
- (c) **review and revise the criteria of selecting cases for quality management checks so that those warranting summary prosecution are selected in time for follow-up action to be taken.**

### **Response from the Administration**

2.26 The **Official Receiver** agrees with the audit recommendations. She has said that:

- (a) quality management assessment is designed to monitor the quality of the case officers' work, to enable immediate follow-up action to be taken to rectify any problems identified in the process, and to check the performance of their supervisors. Quality management assessment is complementary to the supervisory responsibilities of senior staff of the ORO. The ORO will keep the target number of quality management assessment under regular review; and
- (b) regarding the audit recommendation in paragraph 2.25(c), more new cases will be selected for quality management checks. To facilitate more effective checking, the form used in the quality management assessment will also be reviewed.

## Unreleased insolvency cases

2.27 *Release programme.* After realising all the assets of the insolvent and distributing the final dividend if any, the ORO will put an insolvency case on the release programme. For cases put on this programme, the ORO can apply to the court for their releases in accordance with the Companies Ordinance or Bankruptcy Ordinance. A release order issued by the court will discharge the ORO's liability from acting as the liquidator or trustee in the administration of the affairs of the winding-up company or the bankrupt. As at January 2012, the ORO had four staff engaged in preparing applications for release orders and each of them was required to complete six applications each day.

2.28 *Six-month review.* Six months after the granting of the release order, the ORO conducts a review to check whether all costs of a released case have been settled and prepares a final account, including:

- (a) using the remaining cash balance to settle any outstanding ORO fees;
- (b) refunding any petitioner's deposit and settling any outstanding petitioner's taxed costs or part thereof;
- (c) transferring any unclaimed or undistributed money to the Bankruptcy Estates Account (Note 9); and
- (d) transferring to the general revenue any money in the Companies Liquidation Account (see para. 3.20(a)) which remains unclaimed or undistributed for a period of five years.

## Audit observations and recommendations

2.29 Audit examined the year-end figures of the release programme and found that the number of unreleased insolvency cases had increased from 2,385 in 2000 to 85,615 in 2011, i.e. an increase of 35 times over the past 12 years (see Appendix D). According to the ORO, the increase was due to a drastic increase in caseload from 5,516 (4,606 bankruptcy and 910 winding-up) cases in 2000 to 8,314 (7,981 bankruptcy and 333 winding-up) cases in 2011, with a peak of 26,620 (25,328 bankruptcy and 1,292 winding-up) cases in 2002 (see Figures 1 and 3 in paras. 1.2 and 1.3 respectively). With a daily throughput of 24 cases (see para. 2.27), it may take a long time to clear the backlog. As a release order issued by the court will discharge the ORO's liability from

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**Note 9:** *The Account is established under the Bankruptcy Ordinance for depositing unclaimed or undistributed money. Any money which has remained unclaimed in the Account for a period of five years may be transferred to the general revenue.*

acting as the liquidator or trustee in the administration of the affairs of the winding-up company or the bankrupt, the ORO needs to expedite action on the outstanding unreleased cases to protect itself from unnecessary risk.

2.30 Audit also noted that, up to October 2011, the ORO had not completed a review of about 5,000 bankruptcy cases with release orders granted during the period from December 2009 to April 2011. The ORO needs to complete the review so that any unclaimed or undistributed money will be transferred to the Bankruptcy Estates Account as soon as possible.

#### *Audit recommendations*

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

- (a) **expedite action on applying for release orders for the insolvency cases listed in the release programme; and**
- (b) **complete the review of the released bankruptcy cases with a view to transferring any unclaimed or undistributed money to the Bankruptcy Estates Account as soon as possible.**

#### **Response from the Administration**

2.32 The **Official Receiver** agrees with the audit recommendations. She has said that:

- (a) due to the increasing number of cases (see para. 2.29), the ORO has been focusing its efforts on fulfilling other statutory duties as the trustee in bankruptcy cases (e.g. realisation of assets and investigation work) which are comparatively more important and time-sensitive from the perspective of protection of the interests of creditors; and
- (b) the ORO has already posted one additional permanent staff and redeployed temporarily another five staff to assist in cutting down the backlog of unreleased cases. The ORO is also actively considering the establishment of a dedicated team, as a longer term action plan, to clear the backlog in as short a time frame as possible.

## **PART 3: OUTSOURCING OF INSOLVENCY CASES**

3.1 This PART examines the following issues relating to the ORO's outsourcing of insolvency cases:

- (a) admission of PIPs under Panel A scheme (paras. 3.3 to 3.11);
- (b) monitoring of PIPs' performance (paras. 3.12 to 3.19);
- (c) audit of accounts submitted by PIPs (paras. 3.20 to 3.28); and
- (d) review of resource deployment (paras. 3.29 to 3.33).

### **Outsourcing schemes**

3.2 Since 1996, the ORO has outsourced some of its winding-up cases to PIPs. In line with the recommendations of the 2002 consultancy study (see para. 1.5(a)) that the ORO should be more a regulator than dealing with insolvency cases (Note 10), the ORO has also outsourced some of its bankruptcy cases. At present, the ORO operates four outsourcing schemes, summarised as follows:

- (a) ***Panel A scheme.*** The scheme was established by the ORO in conjunction with the Hong Kong Institute of Certified Public Accountants (HKICPA) in 1996 for outsourcing non-summary winding-up cases. Professional firms meeting the prescribed requirements may apply for admission as Panel A PIPs (see para. 3.4). They charge fees as approved by the committee of inspection (see Note 4 to Appendix B) or by the court to the insolvent companies' estates. No government subsidy would be provided even if the estates are insufficient to meet their costs. At present, there are 14 firms (Note 11) on the panel list;
- (b) ***Panel T scheme.*** In 2000, the ORO introduced this scheme to outsource its summary winding-up cases. In response to the 2000 audit recommendation, the ORO has since 2001 used a tender system to appoint professional firms (in the accounting, legal and secretarial fields) with relevant insolvency work experience as Panel T PIPs. These PIPs charge fees on a time-cost basis to the insolvent companies' estates and a government subsidy (up to their tendered amount) would be provided if the estates are insufficient to meet their costs.

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**Note 10:** *In a public consultation conducted in mid-2002, most respondents supported this recommendation.*

**Note 11:** *The ORO assigns cases to PIPs of the four outsourcing schemes on a rotation basis.*

According to the ORO, through price competition under the tender system, the average amount of government subsidy per case decreased from \$28,400 in 2000-01 to \$1,775 in 2009-10. There are 10 Panel T PIPs under the current contract from April 2010 to March 2012;

- (c) ***Debtor-petitioned summary bankruptcy case scheme.*** This scheme (bankruptcy case scheme) was introduced in 2008 as a pilot scheme covering 15% of the debtor-petitioned summary bankruptcy cases. The ORO selects professional firms as PIPs for this scheme by an open tender. The selected PIPs charge their fees to the bankrupts' deposits (Note 12) and estates and there is no government subsidy provided. There are five PIPs under the current contract from January 2012 to December 2013 to handle 25% of the debtor-petitioned summary bankruptcy cases; and
- (d) ***Preliminary examination scheme.*** This scheme was introduced in 2003 for those debtor-petitioned bankruptcy cases handled by the ORO. The ORO selects professional firms as PIPs under this scheme by an open tender. The PIPs' services include interviewing the bankrupts, explaining to them the bankruptcy procedures and examining their submitted preliminary examination questionnaires. The PIPs are remunerated by the ORO out of the bankrupts' estates. There are 10 PIPs under the current contract from January 2012 to December 2013.

### **Admission of PIPs under Panel A scheme**

3.3 For administering Panel A scheme, the ORO has set up an Approval Committee comprising three ORO staff (one of whom is a Chief Treasury Accountant acting as the chairman) and three representatives of the HKICPA. The Committee shall meet on a regular basis to consider new applications, review complaints and make any reprimands or disqualifications of PIPs from the scheme.

3.4 Professional firms applying for admission as PIPs under Panel A scheme must have adequate resources, namely at least four professional accountants, two of whom must be insolvency practitioners meeting the following basic requirements:

- (a) qualified as a member of the HKICPA; and

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**Note 12:** *The Bankruptcy Rules of the Bankruptcy Ordinance require the petitioner (i.e. the debtor in this context) to deposit \$8,650 with the ORO at the time of petition to cover the fees and expenses of the bankruptcy proceedings.*

- (b) having worked for a minimum of 600 chargeable hours of relevant insolvency work in the last three years or 750 chargeable hours in the last five years, with a minimum of 100 chargeable hours in any one year; or having been appointed to 10 unconnected insolvency cases in the last five years.

All insolvency practitioners under Panel A scheme must be registered with the Approval Committee.

3.5 In 2000, the Approval Committee agreed to the following new requirements for registering an insolvency practitioner:

- (a) in addition to fulfilling the basic requirements (see para. 3.4(a) and (b)), the applicant must be at manager rank or above; and
- (b) if the applicant meets the working experience requirement (see para. 3.4(b)) and is at manager rank or above, the applicant does not need to be a member of the HKICPA (see para. 3.4(a)).

## **Audit observations and recommendations**

### *Frequency of meetings*

3.6 From 2002 to 2005, the ORO guidelines stipulated that the Approval Committee should meet on a quarterly basis (Note 13). However, the number of meetings held during this period fell short of the requirement. In particular, no meeting was held in 2004 and only one meeting each was held for 2002, 2003 and 2005. As a result, 17 new applications for admission to Panel A scheme received in 2003 and 2004 had to wait for 9 to 22 months before they were considered by the Approval Committee in September 2005. The ORO needs to ensure that the stipulated frequency of meetings is followed so that the business of the Approval Committee is dealt with in a timely manner.

### *Admission requirements*

3.7 **Promulgation.** Up to January 2012, the ORO had not promulgated the admission requirements of Panel A scheme in its publications and website. The basic requirements (see para. 3.4) were promulgated on the HKICPA's website. With the introduction of the new requirements in 2000 (see para. 3.5), it has become more important for the ORO to promulgate all the admission requirements for information of relevant stakeholders, viz:

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**Note 13:** *The Approval Committee agreed in September 2005 that its meetings should be convened every six months.*



- (a) suitably qualified accountants not being a member of the HKICPA need to be informed that they are now eligible for registration as insolvency practitioners; and
- (b) applicant firms need to be informed that their insolvency practitioners must be of manager rank.

In this connection, Audit noted that from 2003 to 2007, seven applications were rejected solely on the grounds that the insolvency practitioners in the applicant firms were not at manager rank.

3.8 **Review.** In 2007, some Approval Committee members expressed concerns that the prescribed admission requirements might be outdated as most of them had been laid down since 1996. In November 2007, the ORO suspended the admission of new PIPs under Panel A scheme and in May 2008 set up a working group, with the participation of the Financial Services and the Treasury Bureau (FSTB), to review the scheme. In 2009, the working group completed its task and finalised a preliminary draft of proposed amendments to the Panel A scheme which were aimed to tighten the admission criteria (Note 14).

3.9 In March 2011, having regard to some Approval Committee members' suggestion and given that a number of admission applications had been received, the ORO decided to resume processing the applications (based on the existing admission requirements) in parallel with the ongoing review of the scheme. In May 2011, in the light of the HKICPA's comments, the ORO revised the preliminary draft for the HKICPA's further comments. In December 2011, the ORO was considering the HKICPA's comments on the revised draft, particularly the proposed admission requirements. In Audit's view, the ORO needs to expedite action on the review of Panel A scheme with a view to implementing any necessary improvement measures (such as updating the admission requirements) as soon as possible.

#### ***Audit recommendations***

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

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**Note 14:** *For example, one of the proposals was requiring Panel A PIPs to have at least 16 full-time employees performing insolvency services. After receiving policy support from the FSTB, in October 2009, the ORO sought the HKICPA's views on this preliminary draft. At present there is no requirement on the staff number of Panel A PIPs whereas Panel T PIPs are required to have at least 10 full-time employees performing insolvency services.*

- (a) ensure that the stipulated frequency for meetings of the Approval Committee is followed so that its business is dealt with in a timely manner;
- (b) promulgate in the ORO publications and website all the admission requirements of Panel A scheme for information of relevant stakeholders; and
- (c) expedite action on the review of Panel A scheme with a view to implementing any necessary improvement measures as soon as possible.

### **Response from the Administration**

3.11 The **Official Receiver** agrees with the audit recommendations. She has said that:

- (a) the ORO will ensure that the stipulated six-monthly meetings (see Note 13 to para. 3.6) will be followed so that all relevant business of the Approval Committee is dealt with in a timely manner. Between meetings, Panel A scheme business has been effectively conducted by the Approval Committee through circulation of papers, e.g. from April 2008 to January 2012, 43 applications were received and considered by the Committee in this manner;
- (b) the ORO has uploaded onto its website all the admission requirements of Panel A scheme for relevant stakeholders' information. The ORO will update the information from time to time to ensure that the most up-to-date requirements will be made available to stakeholders and the public on the website; and
- (c) in response to the HKICPA's comments received in November 2011, the ORO issued revised draft rules to the HKICPA in late February 2012. The ORO plans to promulgate the new rules in mid-2012.

### **Monitoring of PIPs' performance**

3.12 The ORO has implemented measures for monitoring the PIPs under the four outsourcing schemes as shown in Table 1. Based on the monitoring results, the ORO may take regulatory actions, such as suspending the allocation of new cases to a PIP and applying to the court for removal of a PIP as the liquidator or trustee when there is a serious breach of his statutory duties.

Table 1

## Monitoring measures

Scheme	Measures
Panel A	<ul style="list-style-type: none"> <li>(a) checking liquidator accounts submitted by PIPs (see para. 3.20(b));</li> <li>(b) monitoring funds paid into the Companies Liquidation Account (see para. 3.20(a)); and</li> <li>(c) monitoring allegations against the PIPs.</li> </ul>
Panel T	<ul style="list-style-type: none"> <li>(a) to (c) same as Panel A scheme above;</li> <li>(d) monitoring key stages of the winding-up process such as summary procedure order; and</li> <li>(e) conducting quality checks of the outsourced cases (to be implemented under the new contract commencing April 2012).</li> </ul>
Bankruptcy case	<ul style="list-style-type: none"> <li>(a) monitoring key stages of the bankruptcy process such as summary procedure order;</li> <li>(b) checking trustee accounts submitted by PIPs;</li> <li>(c) checking the statutory required annual statement of proceedings;</li> <li>(d) conducting quality checks of 10% of the outsourced cases; and</li> <li>(e) monitoring allegations against the PIPs.</li> </ul>
Preliminary examination	<ul style="list-style-type: none"> <li>(a) conducting periodic quality checks of the outsourced cases; and</li> <li>(b) monitoring allegations against the PIPs.</li> </ul>

Source: ORO records

## Audit observations and recommendations

### *Timing of quality check*

3.13 Audit found that the ORO's quality checks conducted for the bankruptcy case scheme were spread out evenly over the entire contract periods (e.g. by four exercises for the 2008-10 contract). However, for the preliminary examination scheme, the quality checks were conducted in two exercises (one in November 2008 and another in August 2009) for the 2008-10 contract. In other words, no quality checks were conducted on outsourced cases of September 2009 to April 2010. For the 2010-11 contract, the quality checks were conducted in one exercise (in September 2011, three months before the end of the contract period). Audit considers that the quality checks should be conducted evenly throughout the contract period so that the PIPs' performance is kept under regular monitoring and any under-performance can be earlier detected for taking regulatory action.

### *Regulatory action on unsatisfactory performance*

3.14 The ORO has compiled management reports on the results of its quality checks. Audit examined these management reports for the 2008-10 contracts of both the preliminary examination scheme and bankruptcy case scheme. While the reports showed that the PIPs' performance of the bankruptcy case scheme was generally acceptable, that of the preliminary examination scheme was less satisfactory, summarised as follows:

- (a) 42% of cases had delays (of eight days on average) in interviewing the bankrupts (Note 15); and
- (b) 29% of cases had delays (of nine days on average) in submission of preliminary examination reports to the ORO (Note 16).

3.15 For two PIPs (PIP A and PIP B) in particular, they had repeated delays in interviewing the bankrupts and submission of preliminary examination reports to the ORO. Of the 20 cases selected for quality checks for each of them, PIP A had delays (averaging 5 days for conducting interview and 14 days for report submission) in all 20 cases (100%) and PIP B had delays (averaging 10 days for conducting interview and 12 days for report submission) in 14 cases (70%). However, apart from drawing the two PIPs' attention to their unsatisfactory performance and reminding them to observe the terms of contract, the ORO did not conduct further checks or take any regulatory action.

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**Note 15:** *The contract required the responsible PIPs to interview a bankrupt within three working days after the bankruptcy order was made. The delays are counted in calendar days.*

**Note 16:** *The contract required the responsible PIPs to submit a preliminary examination report within seven working days after the interview was conducted. The delays are counted in calendar days.*

3.16 The contract conditions provide that the ORO can terminate the contract of a PIP if he:

- (a) fails to carry out all or any of the services;
- (b) delivers service of unsatisfactory quality; or
- (c) breaches any terms and conditions of the contract.

The ORO records showed that, since the implementation of this outsourcing scheme in 2003, the ORO had not invoked this provision. In Audit's view, the ORO needs to take, in serious cases, stringent regulatory action against non-compliant PIPs.

#### ***Past performance for tender evaluation***

3.17 As a test check on whether the ORO has taken into account the past performance of PIPs in considering their new tenders for appointment under three outsourcing schemes (i.e. except Panel A scheme), Audit examined the tendering exercises of these schemes conducted in 2009 and 2010. According to the ORO's tender assessment reports, the performance of all those selected PIPs who had taken up previous appointments was acceptable. However, based on the results of the ORO's monitoring measures, Audit found that three selected PIPs under two schemes in fact had unsatisfactory past performance. Their performance after reappointment under new contracts continued to be unsatisfactory, as summarised below:

- (a) ***Preliminary examination scheme.*** As mentioned in paragraph 3.15, the performance of PIP A and PIP B was less than satisfactory during the 2008-10 contract. However, they were still selected as PIPs for the 2010-11 contract during which there was little improvement in their performance. Of the six cases selected for quality checks for each PIP under the 2010-11 contract, PIP A had delays (averaging 12 days for conducting interview and 14 days for report submission) in three cases (50%) and PIP B had delays (averaging 9 days for conducting interview and 22 days for report submission) in four cases (67%); and
- (b) ***Panel T scheme.*** As at January 2010, one PIP had delays of up to nine months in submitting 36 liquidator accounts (see para. 3.20(b)). However, in March 2010, he was still selected for appointment under the 2010-12 contract (commencing April 2010). As at October 2011, he had delays in submitting 35 accounts. One of the 35 accounts was overdue for more than nine months.

*Audit recommendations*

- 3.18 **Audit has recommended that the Official Receiver should:**
- (a) **conduct quality checks of outsourced insolvency cases evenly throughout the contract period so as to keep the PIPs' performance under regular monitoring;**
  - (b) **step up monitoring of non-compliant PIPs and take stringent regulatory action in serious cases; and**
  - (c) **duly take into account PIPs' past performance in evaluating their tenders for reappointment under a new contract.**

**Response from the Administration**

- 3.19 The **Official Receiver** agrees with the audit recommendations. She has said that:
- (a) for some cases, the delays in interviewing the bankrupts (see para. 3.14(a)) were due to difficulties encountered by the PIPs in arranging interviews with the bankrupts;
  - (b) for delays within the PIPs' control and other less serious breaches of duty, the ORO has issued warning letters to the PIPs concerned. For serious non-compliant cases, actions have been taken to apply to the court for disqualifying or removing the PIPs concerned from acting as the liquidator or trustee. In this regard, 11 PIPs have been removed or disqualified. Moreover, the ORO will explore the possibility of discontinuing contracts with the PIPs involving serious and persistent non-compliance; and
  - (c) to step up the monitoring of PIPs, the ORO will establish a regulatory and compliance section dedicated to monitoring their performance, including the submission of accounts (see para. 3.22), and the enforcement of statutory and other relevant contractual obligations. The ORO will also review the terms of future outsourcing contracts and consider the introduction of a marking scheme to ensure the quality of outsourced services. Training sessions will be organised from time to time to further enhance staff's understanding of the ORO's monitoring and supervisory roles.

## Audit of accounts submitted by PIPs

3.20 The accounting requirements on receipts and payments of all PIPs (Note 17) when acting as the liquidators or trustees are laid down in the Companies Ordinance and Bankruptcy Ordinance, as summarised below:

- (a) **Receipts and payments.** For a winding-up case, a PIP shall pay the proceeds of realised assets and his other receipts as the liquidator into the Companies Liquidation Account kept by the ORO. The ORO is responsible for authorising payments to be made by the PIP out of the Companies Liquidation Account. For a bankruptcy case, a PIP shall maintain a bankruptcy account for all receipts and payments as the trustee; and
- (b) **Submission of accounts.** A PIP shall submit an account of his receipts and payments as the liquidator (liquidator account) to the ORO twice a year. In accordance with the provisions of the Bankruptcy Ordinance, the ORO has required a PIP to submit an account of his receipts and payments as the trustee (trustee account) every two years. In submitting the trustee account, the PIP is also required to remit to the ORO the ad valorem fee (Note 18). The ORO may cause the submitted liquidator and trustee accounts to be audited. These accounts (whether audited or not) shall be filed with the court and made available for inspection by any interested parties upon payment of a fee.

3.21 The ORO has laid down the following requirements on the checking of the liquidator and trustee accounts submitted by PIPs:

- (a) **Preliminary checking.** All liquidator and trustee accounts shall be preliminarily checked for content and accuracy by the Case Management Division (for summary cases) and the Financial Services Division (for non-summary cases); and
- (b) **Field audit.** The Financial Services Division also carries out field audits of selected accounts to inspect the PIPs' books, accounts and vouchers. The criteria for selecting accounts for field audits are summarised as follows:

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**Note 17:** *These requirements apply to PIPs under the ORO's outsourcing schemes and those directly appointed by the court or creditors.*

**Note 18:** *For a winding-up case, the ORO may charge the ad valorem fee against the estate money in the Companies Liquidation Account (see para. 3.20(a)).*

*Liquidator accounts*

- (i) material accounts with receipts over \$8 million or payments over \$5 million;
- (ii) 2% of non-summary cases selected on statistical sampling basis;
- (iii) 4% of the outsourced summary cases;

*Trustee accounts*

- (iv) material accounts with receipts over \$8 million or payments over \$5 million;
- (v) 2% of creditor-petitioned non-summary cases and 1% of debtor-petitioned non-summary cases selected on statistical sampling basis; and
- (vi) 5% of the outsourced debtor-petitioned summary cases.

**Audit observations and recommendations**

*Submission of accounts*

3.22 Audit examination revealed that as at October 2011, there were 3,792 overdue liquidator and trustee accounts not yet received by the ORO (Note 19). Table 2 is an ageing analysis of these outstanding accounts.

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**Note 19:** *The ORO did not have information on the number of accounts due in a year. Based on the number of the active insolvency cases as at December 2011 and the stipulated frequency of submission of accounts (see para. 3.20(b)), Audit estimated that the number of accounts due in a year was about 14,000. The 3,792 outstanding accounts represented 27% of the estimated accounts due.*



**Table 2**  
**Outstanding liquidator and trustee accounts**  
**(October 2011)**

Overdue period	Liquidator accounts		Trustee accounts		Total
	Number	%	Number	%	
≤ 9 months	408	95%	2,050	61%	2,458
> 9 months	22	5%	1,312	39%	1,334
<b>Total</b>	<b>430</b>	<b>100%</b>	<b>3,362</b>	<b>100%</b>	<b>3,792</b>

Source: ORO records

3.23 In Audit's view, the ORO needs to urge the PIPs concerned to submit the outstanding accounts, particularly the trustee accounts. This is because late submission of these accounts could also mean delay in remitting the ad valorem fees to the ORO (see para. 3.20(b)). The ORO also needs to regularly monitor the submission of accounts by PIPs with a view to identifying those who are repeatedly late in submitting accounts. For the frequent non-compliant PIPs under the outsourcing schemes, the ORO needs to take regulatory action in accordance with the contract provisions. For those PIPs directly appointed by the court or creditors (see Note 17 to para. 3.20), the ORO may consider taking actions such as issuing warning letters to them.

3.24 Audit notes that the Case Management Division has made use of its computer system for managing trustee and liquidator accounts due from PIPs of the outsourcing schemes. For example, the computer system generates reminders and warning letters if the accounts are overdue. However, the ORO did not have a similar system for monitoring the submission of accounts due from those PIPs directly appointed by the court or creditors. For operational efficiency, there is merit to consider enhancing the computer system to cover these accounts.

### *Checking of accounts*

3.25 Audit examination revealed that as at December 2011, the Financial Services Division had not carried out preliminary checking of 1,139 accounts of non-summary cases and field audit of 257 accounts (see para. 3.21(a) and (b)). Ageing analyses of these accounts are shown in Tables 3 and 4. In response to Audit enquiry in December 2011, the

ORO said that it had drawn up an action plan (with target monthly output) in October 2011 for clearing the backlog within 23 months. In Audit's view, the ORO needs to monitor the implementation of the action plan, and take measures to improve the timeliness in conducting preliminary checking and field audit in future.

Table 3

**Ageing analysis of submitted accounts not yet checked  
(December 2011)**

<b>Outstanding period (Note)</b>	<b>Number of liquidator accounts</b>	<b>Number of trustee accounts</b>	<b>Total</b>
Less than 1 year	530	68	598
1 year to 5 years	452	75	527
Over 5 years	1	13	14
<b>Total</b>	<b>983</b>	<b>156</b>	<b>1,139</b>

*Source: Audit analysis of ORO records*

*Note: The period is counted from the date of receipt.*

Table 4

**Ageing analysis of selected accounts not yet audited  
(December 2011)**

<b>Outstanding period (Note)</b>	<b>Number of liquidator accounts</b>	<b>Number of trustee accounts</b>	<b>Total</b>
Less than 1 year	88	6	94
1 year to 5 years	152	0	152
Over 5 years	11	0	11
<b>Total</b>	<b>251</b>	<b>6</b>	<b>257</b>

*Source: Audit analysis of ORO records*

*Note: The period is counted from the date of selection.*

3.26 While the Case Management Division is responsible for preliminary checking of the accounts for summary cases, it has not maintained statistics on accounts not yet checked. Without such management information, the ORO is not in a position to monitor whether there is any delay in conducting preliminary checking by the Case Management Division. In January 2012, the ORO informed Audit that it had started to enhance its computer system to monitor the Division's checking of accounts.

#### *Audit recommendations*

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

- (a) **urge the PIPs concerned to submit the overdue accounts mentioned in paragraph 3.22 and remind them to remit the ad valorem fee;**
- (b) **strengthen the monitoring of submission of accounts by PIPs with a view to identifying those who are repeatedly late in submitting accounts for taking regulatory action;**
- (c) **consider enhancing the computer system for managing the submission of liquidator and trustee accounts to cover those due from PIPs directly appointed by the court or creditors;**
- (d) **closely monitor the implementation of the action plan for clearing the backlog of accounts pending preliminary checking and field audit by the Financial Services Division;**
- (e) **take measures to improve the timeliness in conducting preliminary checking and field audit in future; and**
- (f) **closely monitor the implementation of the computer system enhancement for monitoring the checking of accounts by the Case Management Division.**

#### **Response from the Administration**

3.28 The **Official Receiver** agrees with the audit recommendations. She has said that:

- (a) the ORO has issued letters to all PIPs concerned urging them to submit their liquidator and trustee accounts in a timely manner. The ORO will introduce enhanced procedures to take follow-up actions against PIPs with unexplained consistent default, including issuing warning letters and reporting the matter to the court. For PIPs appointed under the ORO's outsourcing schemes, consideration will also be given to terminating the contract in cases of serious default;

- (b) the ORO will take immediate action to enhance the computer system for managing the submission of liquidator and trustee accounts;
- (c) the ORO will explore the possibility of introducing enhanced measures to advance the target of clearing the backlog of accounts pending preliminary checking and field audit;
- (d) the ORO will continue to review its operational procedures with a view to improving the timeliness in the examination and field audit of the accounts in future; and
- (e) upon the completion of the enhancement of the computer system (see para. 3.26) around April 2012, the ORO will be able to easily ascertain those outstanding accounts that have not been checked and to take follow-up action as appropriate.

### **Review of resource deployment**

3.29 The 2002 consultancy study recommended that the ORO should:

- (a) be more a regulator than dealing with insolvency cases (see para. 3.2); and
- (b) review its resource deployment to focus more on the supervision and monitoring of PIPs, upon outsourcing of most of the insolvency cases.

### **Audit observations and recommendation**

3.30 After the 1998 Asia financial crisis, the number of bankruptcy cases increased from 893 in 1998 to 25,328 in 2002. To cope with the increased bankruptcy cases over the years, the ORO has implemented two outsourcing schemes to reduce its in-house bankruptcy casework since 2003, as follows:

- (a) one scheme for outsourcing the preliminary examination work was introduced in 2003 (see para. 3.2(d)). The ORO estimated that the average savings per case were about 1.5 man-hours. Based on this estimate and the number of outsourced cases in the past 8.5 years (from July 2003 to December 2011), Audit calculated that the time savings averaged about 11,900 man-hours a year; and
- (b) in 2008, the ORO implemented another outsourcing scheme for the debtor-petitioned summary cases (see para. 3.2(c)). In 2010, the scheme was expanded to cover 25% of such cases (up from 15% in 2008). According to the ORO, the amount of time and work involved in such cases varied considerably and it was difficult to estimate the amount of savings in man-hours. In terms of caseload, Audit noted that the number of bankruptcy cases decreased from 11,063 in 2007 to 7,981 in 2011, except for an upsurge of 16,157 cases in 2009 (see Figure 1 in para. 1.2).

3.31 Up to December 2011, the ORO had not reviewed its resource deployment to focus more on its regulatory function in the light of the aforesaid decrease in its casework. Meanwhile, there was a backlog in some of the ORO's regulatory work (such as the outstanding liquidator/trustee accounts pending checking and field audit mentioned in para. 3.25). In Audit's view, the ORO needs to review its resource deployment to ensure that any staff savings as a result of outsourcing casework are redeployed for strengthening its regulatory function.

*Audit recommendation*

3.32 **Audit has recommended that the Official Receiver should review the ORO's resource deployment to ensure that any staff savings as a result of outsourcing casework are redeployed for strengthening its regulatory function.**

**Response from the Administration**

- 3.33 The **Official Receiver** agrees with the audit recommendation. She has said that:
- (a) there has been a steady shift of the ORO to a regulatory role with more outsourcing of cases. As mentioned in paragraph 3.19(c), the ORO will establish a dedicated regulatory and compliance section to monitor PIPs' performance; and
  - (b) regarding the ORO's caseload (see para. 3.30(b)), the bankruptcy cases in 2011 are still nine times higher than those in 1998 (or more than five times in terms of insolvency cases). Furthermore, the ORO is required to administer bankruptcy cases for at least four years each and in some cases for eight years.

## **PART 4: FEES AND CHARGES**

4.1 In line with the “user pays” principle, the ORO charges fees for providing various insolvency services. This PART examines the following issues relating to the fees and charges of the ORO:

- (a) cost recovery rate (paras. 4.6 to 4.17); and
- (b) costing exercise for fees and charges review (paras. 4.18 to 4.23).

### **Types of fees and charges**

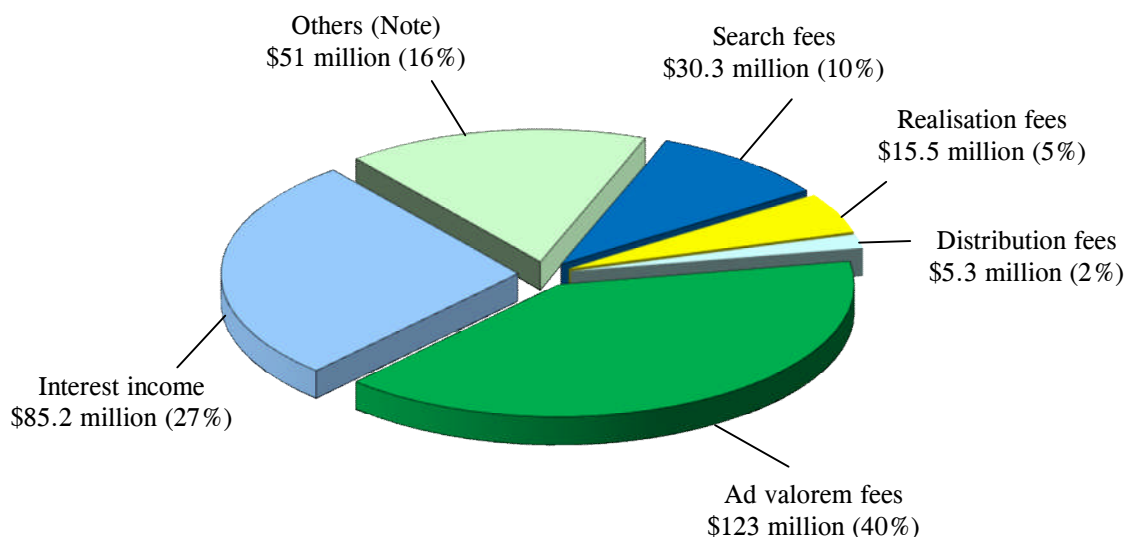
4.2 **Statutory fees.** Fees payable to the ORO in relation to its administration of bankruptcy and winding-up cases are set out in the Bankruptcy (Fees and Percentages) Order (Cap. 6C) and the Companies (Fees and Percentages) Order (Cap. 32C) respectively. The main types of statutory fees include:

- (a) ad valorem fees levied on all insolvency cases handled by the ORO or PIPs (appointed under the outsourcing schemes or by the court and creditors). The fees are charged at progressively reducing rates from 10% to 1% on the aggregate amount of the assets realised;
- (b) realisation fees of 10% of assets realised and distribution fees of 5% of dividends distributed for insolvency cases handled by the ORO; and
- (c) fees on provision of other services, such as \$85 per search on information of insolvency cases.

4.3 **Interest income.** The ORO also earns interest income from depositing monies of the insolvent estates with banks. The Companies Ordinance and the Bankruptcy Ordinance provide that for company liquidation estates not exceeding \$100,000 and all bankruptcy estates, all interest earned is transferred to the general revenue annually. For company liquidation estates exceeding \$100,000, an amount up to 1.5% per annum of the monies invested is collected by the ORO.

4.4 In 2010-11, the ORO’s total income amounted to \$310.3 million. Figure 5 is a breakdown of the total income by income types.

**Figure 5**  
**Income of the ORO**  
**(2010-11)**



Source: ORO records

Note: Other income mainly included the minimum fees of not less than \$12,150 (as prescribed under the Bankruptcy (Fees and Percentages) Order and the Companies (Fees and Percentages) Order respectively) for each insolvency case handled by the ORO.

### Global costing approach

4.5 According to Financial Circular No. 6/2006, it is the government policy that fees charged by the Government should in general be set at levels adequate to recover the full cost of providing the services. In order to achieve full cost recovery, the existing legislation allows for cross-subsidisation among the ORO's fees. In this connection, the Bankruptcy Ordinance and the Companies Ordinance provide that the amount of any fees prescribed therein shall not be limited by reference to the amount of administrative or other costs incurred or likely to be incurred by the Official Receiver in bankruptcy and winding-up cases. According to the ORO:

- (a) the existing legislation gives a legal backing for achieving full cost recovery on an overall basis (i.e. enabling the adoption of global costing approach); and

- (b) due to the intricacies and interdependence of the insolvency services, it is impracticable for the ORO to carry out separate costing for these services and ensure that their fee levels can attain full cost recovery individually (Note 20).

As such, the ORO has adopted a global costing approach in setting its fee levels.

### Cost recovery rate

4.6 For the first two years of operation since its establishment on 1 June 1992 (Note 21), the ORO achieved a surplus totalling \$60 million. However, in the two subsequent years of 1994-95 and 1995-96, the ORO had a total operating deficit of \$114 million. In May 1996, the ORO in conjunction with the FSTB (the then Financial Services Bureau) commenced a review of the ORO's fees. In 1997, 13 fees under the Bankruptcy (Fees and Percentages) Order and 11 fees under the Companies (Fees and Percentages) Order were increased generally in line with the increase in cost due to inflation.

4.7 In October 1999, in view of the fact that the ORO only achieved an average cost recovery rate of 61.9% over the period from 1995-96 to 1998-99, the FSTB agreed with the ORO that a target cost recovery rate should be set at 60% (Note 22). It was also agreed that the following items should be excluded from the calculation of the cost recovery rate:

- (a) non-chargeable costs such as those incurred by the ORO on insolvency prosecution, and policy and legislative development which should be funded by the Government; and
- (b) exceptional incomes derived from atypically large and unrepresentative winding-up cases.

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**Note 20:** *The ORO acts as the trustee or liquidator of last resort for small insolvency cases where there are little or no assets for realisation to cover the costs of administering these cases. According to the 2011-12 Controlling Officer's Report of the ORO, 98% of the new insolvency cases handled by the ORO are non-remunerative cases.*

**Note 21:** *The ORO was formed to take up the function of the Insolvency Division of the former Registrar General's Department.*

**Note 22:** *According to the ORO, 60% was the minimum target which would be subject to a regular review and adjusted accordingly in the light of known circumstances.*



*The 2000 audit*

4.8 In the February 2000 Audit Report, Audit drew attention to the ORO's total operating deficit which amounted to some \$300 million from June 1992 to March 1999. For 1998-99, the cost recovery achieved was 67% only. In its Report No. 34 of June 2000, the PAC urged that the Official Receiver should:

- (a) 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
- (b) critically consider the feasibility of charging fees on the basis of the full cost of insolvency administration in the long term, having regard to the interests of creditors and debtors.

4.9 Through the Government Minute of October 2000, the Administration informed the PAC that:

- (a) over the preceding few years, the ORO had been heavily burdened with a drastic increase in workload. In addition, in the overwhelming majority of insolvency cases handled by the ORO, the realised assets were insufficient to cover the fees of the ORO. That explained why the ORO had continued to operate in deficits; and
- (b) while the ORO would seek to identify areas, legislative or otherwise, where improvement could be made in the short term to simplify the work procedures without compromising the quality of service, there was a need for a more fundamental review of the role of the ORO in the provision of insolvency administration services. The issues of cost recovery rate, the fee structure and fees to be charged would be looked into in a consultancy study to review the role of the ORO.

*Subsequent developments*

4.10 From 2001 to 2011, the ORO continued to report to the PAC the progress made in respect of the issues of fees and cost recovery rate, as summarised in Table 5.

**Table 5**  
**Key progress reported to the PAC**  
**(2001 to 2011)**

Reporting date	Key progress
(a) May 2001	A consultant was appointed in March 2001 to conduct a fundamental review of the role of the ORO in the provision of insolvency administration services.
(b) October 2002	A public consultation paper on the outcome of the consultancy study was published in June 2002 and the consultation period ended in August 2002. The ORO was considering the responses from the public and expected to complete an analysis by the end of 2002.
(c) May and October 2003	Outsourcing bankruptcy cases to PIPs, as one of the recommendations of the consultancy study, could be pursued as soon as possible. The question of the ORO fees and cost recovery rate would be reviewed in 2004 subject to the progress of outsourcing bankruptcy cases to PIPs.
(d) May 2004	The question of the ORO fees and cost recovery rate would be reviewed after the enactment of the Bankruptcy (Amendment) Bill, which was introduced into the Legislative Council in December 2003 (Note).
(e) October 2005 to October 2007	The Bankruptcy (Amendment) Ordinance 2005 was passed by the Legislative Council in July 2005, and would come into operation once the corresponding subsidiary legislation and the administrative logistics were made ready.
(f) May 2008	The Bankruptcy (Amendment) Ordinance 2005 and the corresponding subsidiary legislation came into operation in December 2007. The ORO would review the cost of operation and question of fees and cost recovery rate after implementation of the pilot scheme to outsource bankruptcy cases.
(g) October 2008 and May 2009	The ORO had implemented a pilot scheme to outsource bankruptcy cases on a small scale and started to review the cost of operation.
(h) October 2009 to October 2010	The ORO had been conducting a comprehensive review of its cost of operation and its impact on fees and charges.
(i) May and October 2011	The ORO was reviewing the level of its fees and charges and would consult the Legislative Council Panel on Financial Affairs.

Source: ORO records

Note: The amendment bill was required to empower the ORO to outsource bankruptcy cases to PIPs. It was originally introduced into the Legislative Council as Bankruptcy (Amendment) Bill 2003, but the Bill lapsed as no Bills Committee slot could be assigned. The Bill was reintroduced into the Legislative Council in October 2004.

***Over-recovery of cost***

4.11 Audit examination of the ORO records revealed that from 2000 to 2010, the ORO had conducted five fees and charges reviews (Note 23). According to the ORO's costing statements for the 2009 and 2010 reviews (Note 24), the ORO had continuously achieved cost recovery rates exceeding 100% from 2000-01 onwards (see Figure 6). In February 2012, in response to Audit enquiry, the ORO said that:

- (a) the cost recovery rate reached its peak in 2006-07 (236%) due to the significant rise in revenue as a result of a sharp increase in insolvency cases in 2002 and 2003;
- (b) moreover, there had been a substantial decrease in manpower resources (establishment of the ORO dropping from 254 as at 31 March 2002 to 227 as at 31 March 2006); and
- (c) there had been a downward trend of cost recovery since 2006-07.

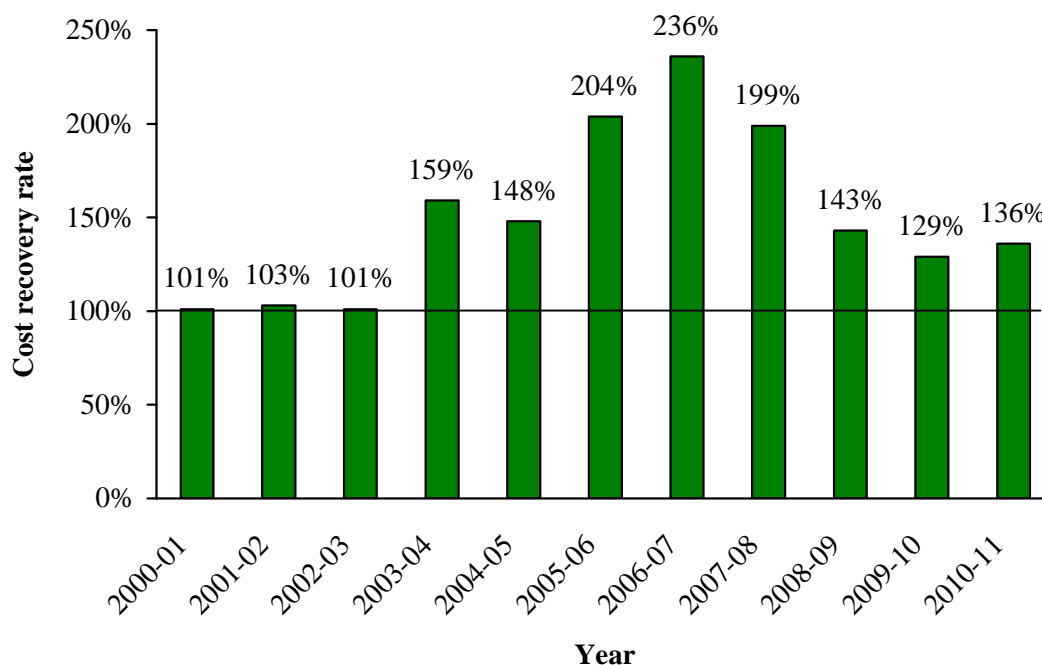
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**Note 23:** *The five reviews were conducted in 2000, 2003, 2004, 2009 and 2010. Based on the results of two of these reviews in 2000 and 2004, the ORO proposed fee increases which were not supported by the Legislative Council Panel on Financial Affairs and the FSTB respectively (see Note 26 to para. 4.19).*

**Note 24:** *According to Financial Circular No. 6/2006, a review of fees and charges should be supported by costing statements duly prepared and vetted in accordance with the Costing Manual published by the Director of Accounting Services. The Costing Manual states that a costing exercise usually requires the computation of the actual and/or estimated costs for a past or current period, and the costing for fees and charges should normally be projected up to the price level of the year for implementing the new fees.*

**Figure 6**

**Cost recovery rate of the ORO  
(2000-01 to 2010-11)**



*Source: ORO records*

*Remarks: The cost recovery rate for 2010-11 was based on the fees and charges review commenced in 2011 (see item (i) of Table 5 in para. 4.10).*

**Audit observations and recommendations**

***Information to the PAC***

4.12 As shown in Table 5 in paragraph 4.10, from 2001 to 2011, the ORO informed the PAC that:

- (a) the question of fees and cost recovery rate would be reviewed after implementation of the consultant's recommendation on outsourcing bankruptcy cases and the progress thereof (from 2003 to 2008); and
- (b) a comprehensive review was underway (from 2009 to 2011).

As mentioned in paragraph 4.11, the ORO had in fact conducted five fees and charges reviews. Moreover, the PAC was not informed of the fact that the ORO had continuously achieved over 100% cost recovery rates from 2000 to 2011 as opposed to the deficit position when the PAC examined this subject (see para. 4.8). In Audit's view, the ORO needs to provide the PAC with information on all significant developments pertaining to the outstanding issues mentioned in the PAC reports.

### *Operating results*

4.13 A Circular Memorandum issued by the FSTB in 2008 (Note 25) has stipulated that if the result of a fees and charges review shows that the fees are recovering more than the full cost, departments are requested to consider formulating proposals to adjust the fees downwards. For the last two fees and charges reviews conducted by the ORO in 2009 and 2010, the costing results showed that there were operating surpluses in the past years. However, the ORO proposed to maintain the existing fee levels on the grounds that the over-recovery was on a decreasing trend, and the projected cost recovery rate was close to 100%.

4.14 Maintaining the ORO's fee levels unchanged when there is an operating surplus is not consistent with the government charging policy (see para. 4.13). The ORO needs to take into account the actual operating results in addition to the projected cost recovery rates for determining the fee levels. In this connection, Audit noted that in September 2009, the FSTB urged the ORO to complete the overall review (see item (h) of Table 5 in para. 4.10) as soon as possible since there had been a consistent over-recovery by the ORO by a considerable margin. In 2011, the ORO commenced another fees and charges review (see item (i) of Table 5 in para. 4.10). As of February 2012, the ORO was conducting the review in consultation with the FSTB. In Audit's view, the ORO needs to expedite action in this regard.

### *Audit recommendations*

- 4.15 **Audit has recommended that the Official Receiver should:**
- (a) **provide the PAC with information on all significant developments pertaining to any outstanding issues mentioned in the PAC reports;**

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**Note 25:** *The Circular Memorandum set out the implementation arrangements of freezing fees and charges affecting the general public's daily lives as announced by the Chief Executive of the Hong Kong Special Administrative Region. It also stated that despite the freeze, bureaux and departments should continue conducting the review of all fees and charges in accordance with the procedures set out in Financial Circular No. 6/2006.*

- (b) **ensure that the government charging policy is strictly followed in future fees and charges reviews; and**
- (c) **expedite action on the current fees and charges review with a view to rationalising the fee levels as soon as possible.**

### **Response from the Administration**

4.16 The **Official Receiver** agrees with the audit recommendations. She has said that:

- (a) the ORO has been following up with the PAC's recommendations (as set out in para. 4.8) by reviewing its fees and charges over the years having regard to the prevailing economic climate, and formulating fee proposals for internal deliberations. The Administration was aware of the improvement in the ORO's recovery rates since 2000. However, it was agreed in 2003 that a comprehensive review of the ORO's fees and charges could only be conducted after the implementation of the scheme to outsource summary bankruptcy cases to PIPs since the scheme would have implication on the ORO's financial position. As set out in Table 5 in paragraph 4.10, the ORO has kept the PAC informed of the progress of the implementation of the scheme. The ORO will provide the PAC with information on all significant developments; and
- (b) the ORO will, in consultation with the FSTB, expedite action on the current comprehensive fees and charges review on the basis of the guidelines of Financial Circular No. 6/2006 and the Costing Manual. The ORO aims at consulting the Legislative Council Panel on Financial Affairs in the 2012-13 legislative session and will inform the PAC of the consultation results and other significant developments.

4.17 The **Secretary for Financial Services and the Treasury** agrees with the audit recommendations.

### **Costing exercise for fees and charges review**

4.18 For fees and charges review purpose, the ORO conducts a costing exercise to determine the projected cost recovery rate for the coming financial year. Audit examined the relevant costing statements for the five fees and charges reviews conducted from 2000 to 2010 and found that there was room for improvement in their preparations, as detailed in paragraphs 4.19 to 4.21.

## Audit observations and recommendations

### *Cost recovery rate calculation*

4.19 As agreed between the FSTB and the ORO in 1999, the calculation of cost recovery rate should exclude non-chargeable costs (see para. 4.7(a)). However, Audit noted that for the 2003 and 2004 reviews, the ORO used the departmental costs without netting off non-chargeable costs in its calculations. As a result, the projected cost recovery rates for 2003-04 and 2004-05 (which should have been 138% and 115% respectively) were understated as 99% and 82% respectively (Note 26). In Audit's view, the ORO needs to step up its checking of the costing statements prepared for fees and charges reviews.

### *Cost estimates*

4.20 For the 2009 fees and charges review, the ORO worked out a projected cost recovery rate based on the cost estimates for 2009-10. Audit noted that one of the cost estimates (i.e. the government expenditure on subsidising Panel T scheme as mentioned in para. 3.2(b)) constituting 14% of the total was made without due regard to the past expenditure pattern and operational data. It turned out that the estimate was some 20 times more than the actual expenditure in 2009-10. For the 2010 and subsequent fees and charges reviews, the ORO had substantially revised down the estimated expenditure for Panel T scheme. The ORO needs to improve the compilation of cost estimates for fees and charges reviews.

### *Audit recommendations*

4.21 **Audit has recommended that the Official Receiver should, in conducting a costing exercise for fees and charges review:**

- (a) **step up checking of the costing statements; and**
- (b) **take measures to improve the compilation of cost estimates.**

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**Note 26:** *In April 2004, based on the understated cost recovery rate of 82%, the ORO proposed a fee increase. The proposal was not implemented because the FSTB considered that a fee revision should be done after the implementation of the pilot scheme to outsource bankruptcy cases.*

## **Response from the Administration**

4.22 The **Official Receiver** agrees with the audit recommendations. She has said that the full amount of the government subsidy to a PIP under the Panel T scheme will be finalised only after a winding-up case has been released. As there are uncontrollable factors such as the length of proceedings and time taken to obtain the release orders from the court, it is very difficult to make accurate estimation on the amount of government subsidy required. The estimate for 2009-10 was made by the ORO on a prudent and conservative basis.

4.23 The **Secretary for Financial Services and the Treasury** agrees with the audit recommendations.



## **PART 5: INDIVIDUAL VOLUNTARY ARRANGEMENT**

5.1 This PART examines the following issues relating to the ORO's management of individual voluntary arrangement (IVA):

- (a) encouraging greater use of IVAs (paras. 5.3 to 5.10); and
- (b) administering the IVA register (paras. 5.11 to 5.19).

### **Advantages of IVAs**

5.2 In April 1998, the Bankruptcy Ordinance was amended to provide for an IVA as an alternative to bankruptcy. Under an IVA, a debtor makes a repayment proposal to the court and his creditors. If approved, it will legally bind all creditors. The advantages of an IVA are as follows:

- (a) the debtor can avoid the stigma of bankruptcy and will be free from legal restrictions under the Bankruptcy Ordinance; and
- (b) the creditors may expect better repayment from the debtor as the latter would have more incentive to make repayment.

### **Encouraging greater use of IVAs**

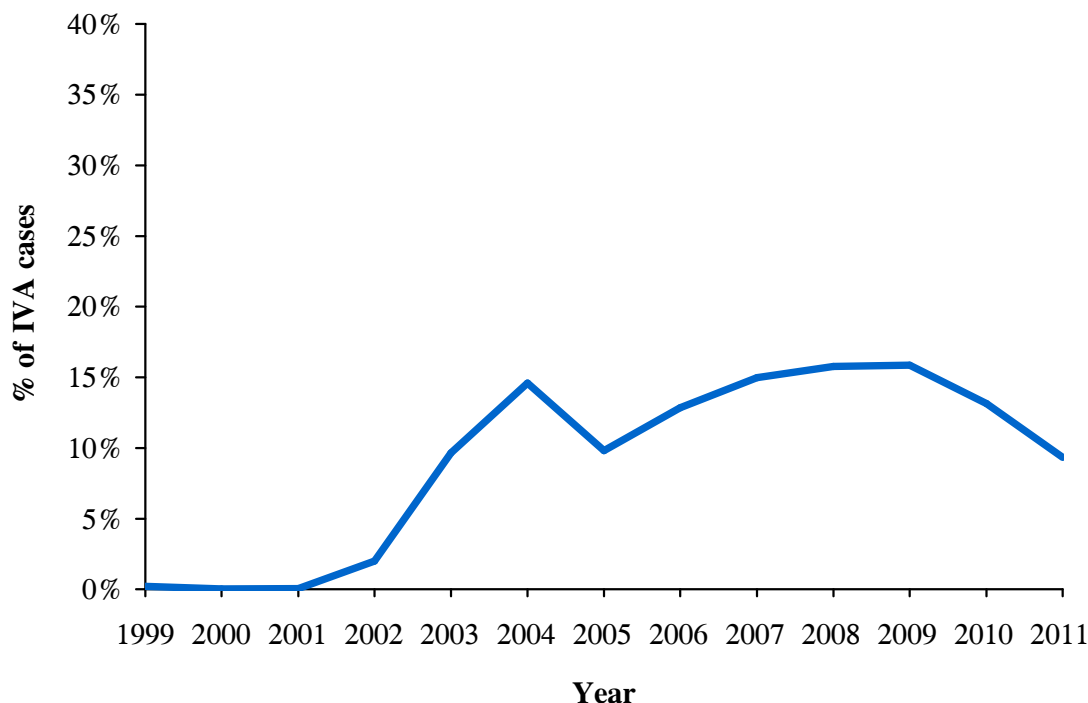
5.3 Since 1999, the ORO has stated in its Controlling Officer's Reports that it will continue to encourage greater use of IVAs by debtors. The ORO has provided, at its counter and website, a guide and other information to assist users in navigating the IVA procedures. For further information, a user may also contact the ORO by phone, mail and e-mail.

### **Audit observations and recommendations**

#### *Use of IVAs*

5.4 Figure 7 shows the use of IVAs as a percentage of total bankruptcy and IVA cases since 1999. It can be seen that after a period of steep growth from 2002 to 2004, the momentum has slowed down. From 2005 onwards, the use of IVAs ranged between 9% and 16%. With the lapse of some 13 years since the ORO first promoting the greater use of IVAs, it is opportune to conduct a review to see if there is room for improvement. For example, Audit noted that in 2003, the ORO actively participated in seminars and talks on IVAs for social workers and members of the public. However, the ORO's participation in these promotional activities has decreased in recent years. In addition, Audit has identified some issues in the provision of assistance and more user-friendly information to potential users (as set out in paras. 5.5 to 5.9) that warrant the ORO's attention.

**Figure 7**  
**Use of IVAs**  
**(1999 to 2011)**



*Source: Audit analysis of ORO records*

### ***Appointment of a nominee***

5.5 To implement an IVA, the Bankruptcy Ordinance requires the debtor to find a person who is prepared to act as a nominee. A nominee may be the Official Receiver or other person who in the opinion of the court has the experience and qualifications to perform the duties of a nominee. Usually an accountant or a solicitor may be appointed to act as a nominee in an IVA case.

5.6 In September 2002, the ORO decided that it would not act as nominees in IVA cases in order to focus its resources to deal with bankruptcy cases. At that time, a member of the ORO Services Advisory Committee (Note 27) enquired when there would be a roster list of accounting/law firms for the IVA scheme. In response, the ORO said that such a

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**Note 27:** *The ORO Services Advisory Committee was established in June 1994 to provide customer input and suggest improvements to the ORO's services. It is a liaison group comprising representatives from the ORO, Consumer Council and professional bodies of banks, accountants, solicitors and secretaries.*

roster system was not appropriate as it would add an unnecessary bureaucratic layer. As a result, a debtor would have to find a nominee in the market. However, the ORO did not provide information about how to find a nominee. In Audit's view, the ORO may consider including the contact information of the legal and accountancy professional bodies in its guide and website so that IVA users may turn to them for assistance in finding a nominee. In addition, the ORO may discuss with these professional bodies on other possible ways of assisting IVA users.

### *Dismissal of a nominee*

5.7 In October 2010, the Ombudsman received a complaint against the ORO that its IVA register (see para. 5.11) showed that the complainant had failed to discharge her obligation under an IVA although she continued to repay the debts after terminating the IVA. The complainant was dissatisfied that the ORO only recorded information provided by her dismissed nominee but refused to reflect her repayment arrangement in the register. In January 2011, the Ombudsman found that it was proper for the ORO not to record the complainant's repayment arrangement as it was outside the scope of the IVA. He also suggested that the ORO should inform IVA users of its statutory duty to maintain an IVA register for public inspection to avoid misunderstanding. In June 2011, the ORO updated its IVA guide. Under the "Procedures" section of the guide, a new paragraph has been added to remind users that the ORO maintains an IVA register for public inspection showing details of approved IVA cases. Under the "Implementation" section of the guide, a note has been added advising debtors and creditors to apply to the court for ruling if they are dissatisfied with any act of a nominee.

5.8 From the user's point of view, it would help if relevant information is put in one place (such as the "Frequently Asked Questions" section) directly advising debtors on how to avoid placing themselves in the same difficult situation as that of the complainant.

### *Audit recommendations*

- 5.9 **Audit has recommended that the Official Receiver should:**
- (a) **review the existing arrangements for supporting IVA users with a view to identifying measures for encouraging greater use of IVAs; and**
  - (b) **provide more assistance and user-friendly information to IVA debtors particularly in relation to the appointment and dismissal of nominees.**

## Response from the Administration

5.10 The **Official Receiver** agrees with the audit recommendations. She has said that:

- (a) an icon on the ORO's website has been created to enable easy access to information on IVAs. Furthermore, pamphlets on IVAs have been placed in prominent positions and posters on IVAs are being prepared for display in the ORO's public areas;
- (b) to encourage the greater use of IVAs and to enhance understanding the rights and obligations of IVAs, action is also being taken to review the ORO's publications on IVAs and to introduce on the ORO's website a new "Frequently Asked Questions" section for IVAs; and
- (c) in addition, the ORO has provided on its website contact details of the professional bodies whose members have acted as nominees for IVA debtors.

## Administering the IVA register

5.11 Under the Bankruptcy Rules of the Bankruptcy Ordinance, the ORO shall maintain an IVA register for public inspection. The ORO shall enter into the register the following matters:

- (a) approval of an IVA with details of the name, Hong Kong identity card number and address of the debtor, the date of the creditors' meeting during which the IVA is approved, and the name and address of the nominee;
- (b) revocation or suspension of the IVA (if any); and
- (c) completion (or otherwise) of the IVA.

The nominee of the IVA concerned is responsible for reporting items (a) and (c) above to the ORO while the person who applied for the revocation or suspension order shall report item (b). The Bankruptcy Rules require the nominee (as chairman of the creditors' meeting) to report an approved IVA case (item (a)) to the ORO immediately after he has filed to the court the chairman's report which shall be within seven days of the creditors' meeting held for approving the IVA.

## Audit observations and recommendations

### *Updating IVA register*

5.12 From April 1998 to October 2011, there were 17,092 cases of approved IVA (handled by PIPs) entered into the IVA register. Audit analysed the dates of submission of reports on these approved IVA cases. In 476 cases (3% of the total), the nominees concerned took more than 14 days after the IVAs had been approved to submit reports to the ORO (see Table 6), i.e. longer than the time required under the Bankruptcy Rules (see para. 5.11).

**Table 6**

**Time taken by nominees to submit reports on approved IVA cases  
(October 2011)**

<b>Time taken (Note)</b>	<b>Number of cases</b>	
≤ 14 days	16,616	
> 14 days to 1 month	252	} 476 (3%)
> 1 month to 1 year	192	
> 1 year (up to 7.5 years in one case)	32	
<b>Total</b>	<b>17,092</b>	

*Source: Audit analysis of ORO records*

*Note: The time is counted from the date of IVA approval to the date of submission of report to the ORO.*

5.13 Audit also analysed the time taken by the ORO in updating the IVA register after receiving reports on approved IVA cases from nominees (see Table 7). It can be seen that in 11,064 cases (65% of the total), the ORO had taken more than seven days to update the IVA register after receiving the nominees' reports.

**Table 7**  
**Time taken to update the IVA register**  
**(October 2011)**

Time taken (Note)	Number of cases
≤ 7 days	6,028
> 7 days to 1 month	7,022
> 1 month to 2 months	3,929
> 2 months (up to 11.4 months in one case)	113
<b>Total</b>	<b>17,092</b>

} 11,064 (65%)

*Source: Audit analysis of ORO records*

*Note: The time is counted from the date of submission of report to the ORO to the date of updating the IVA register.*

5.14 The IVA register is available for public inspection and the ORO has a duty to maintain the information therein up-to-date. The delays in submitting reports on approved IVA cases by some nominees (3%) and the long time by the ORO in updating the IVA register after receiving such reports (65%) are unsatisfactory.

5.15 The ORO needs to monitor regularly the submission of reports by nominees with a view to identifying those who are repeatedly late in submitting reports for follow-up actions. Such actions may include issuing warning letters and in warranted cases, filing complaints with the professional bodies to which the non-compliant nominees belong. The ORO also needs to take measures to improve the timeliness in updating the IVA register after receiving reports from nominees. In this connection, there is merit to set a time target for measuring performance.

***Personal data disclosed in IVA register***

5.16 The IVA register is kept by ORO counter staff and can be inspected by any member of the public upon request. In January 2011, 243 pages of the IVA register were

found missing after an inspection by a member of the public. As the IVA register contains personal data, the ORO reported the incident to the Privacy Commissioner for Personal Data (Privacy Commissioner) and informed him of the following measures taken to prevent recurrence of similar incidents:

- (a) ***Strengthened security measures.*** Members of the public who borrow the IVA register would be requested to fill in a loan record form (the borrower's name and contact number as well as the borrowing and returning date and time would be recorded). They would be designated specific seats where ORO counter staff can keep a watch during the inspection period. ORO counter staff would check if all pages of the IVA register are duly returned by the borrowers; and
- (b) ***Display of personal data.*** As the display of a debtor's name, identity card number and address in the IVA register could conflict with the code of practice issued by the Privacy Commissioner, the ORO would carry out a review of the Bankruptcy Rules. Meanwhile as a stop-gap measure, no address would be shown in the IVA register and only a partial identity card number would be provided.

5.17 Up to December 2011, the ORO had not completed the review of the Bankruptcy Rules. The ORO needs to expedite action in this regard as the current stop-gap measure of concealing debtors' addresses and part of their identity card numbers in the IVA register is not in full compliance with the Bankruptcy Rules.

#### ***Audit recommendations***

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

- (a) **regularly monitor the submission of reports on approved IVA cases by nominees with a view to identifying those who are repeatedly late in doing so for taking necessary follow-up action;**
- (b) **take measures to improve the timeliness in updating the IVA register after receiving reports from nominees and in this connection, consider setting a time target for measuring performance; and**
- (c) **expedite action on reviewing the Bankruptcy Rules to see if any amendment is necessary to the requirements on the display of debtors' personal data so as to accord with the privacy legislation.**

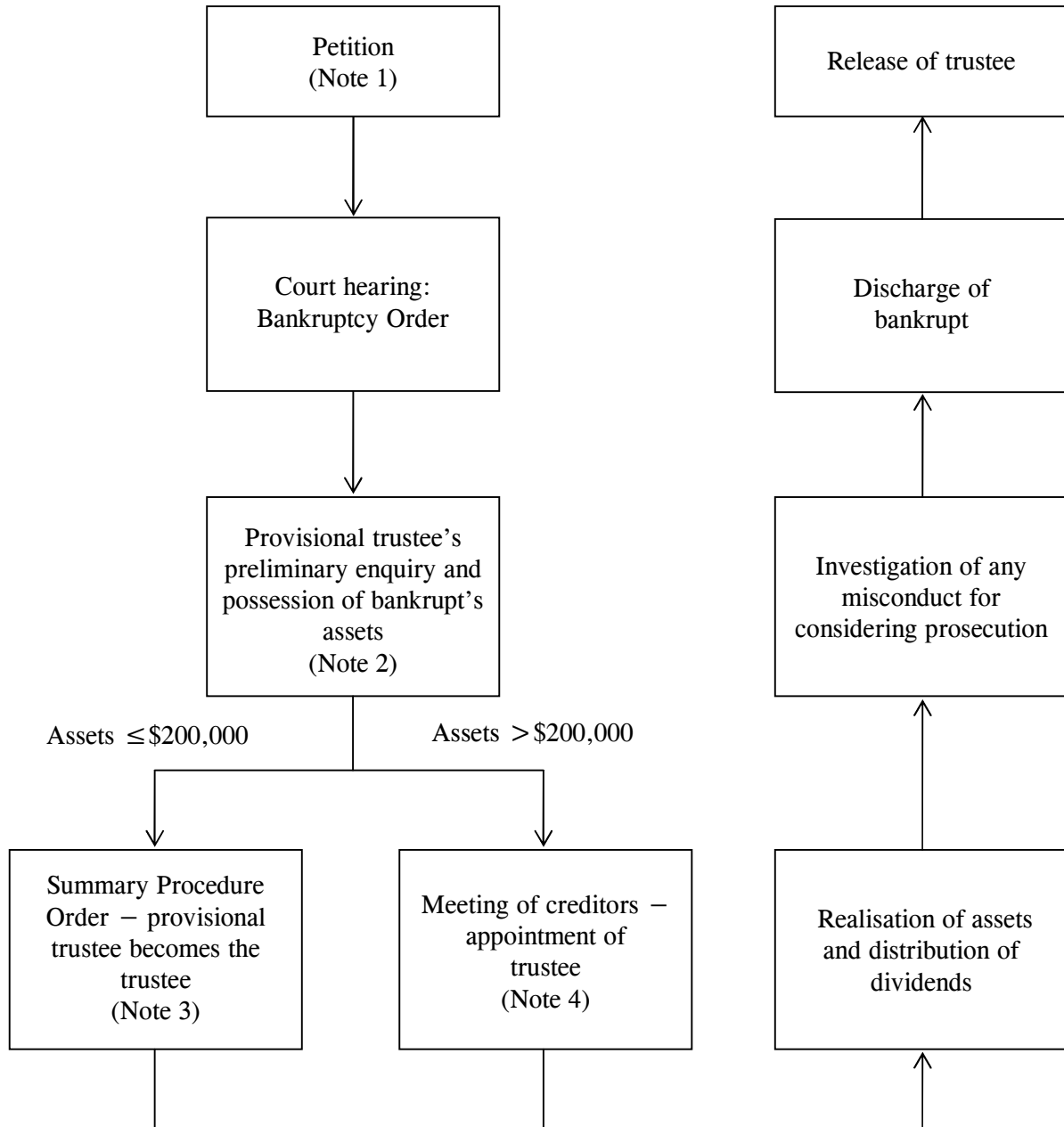
## Response from the Administration

5.19 The **Official Receiver** agrees with the audit recommendations. She has said that:

- (a) nominees and prospective nominees have been reminded of their obligation to send notices and reports to the ORO in accordance with the Bankruptcy Rules. The ORO is considering setting up a register to enhance monitoring of nominees' non-compliance and introducing procedures on follow-up actions in the event of default by the nominees;
- (b) target for updating the IVA registers within five working days of receipt of the requisite information from nominees has been set and implemented; and
- (c) the ORO is taking legal advice on whether there is a need to amend the Bankruptcy Rules to accord with the privacy legislation. The ORO will expedite the legislative process if amendment is required.



Flowchart of bankruptcy procedures



Source: ORO records

Note 1: A petition may be presented by an individual who is unable to pay his debts (debtor-petitioned case), or by his creditors (creditor-petitioned case).

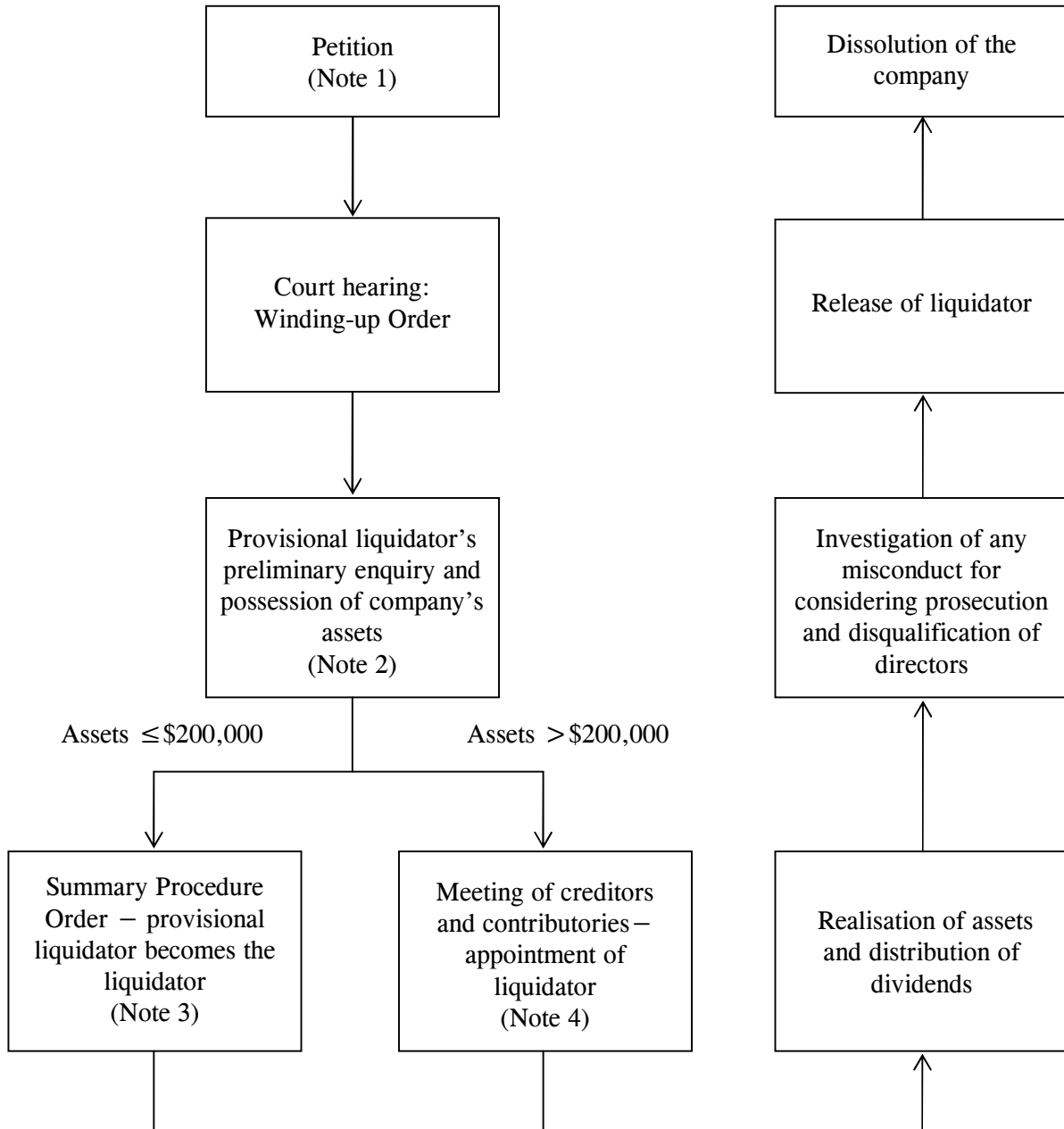
**Appendix A**  
(Cont'd)  
(para. 1.2 refers)

*Note 2: On the making of a bankruptcy order by the court, the Official Receiver shall become the provisional trustee responsible for administering a bankrupt's property (including his money, goods and other assets). In the case of a debtor-petitioned bankruptcy, the Official Receiver as provisional trustee may appoint any qualified person to act as provisional trustee if a bankrupt's assets are unlikely to exceed \$200,000 (summary case).*

*Note 3: For a summary case, the provisional trustee shall apply to the court for a summary procedure order and becomes the trustee. A trustee's duties include realising a bankrupt's assets and paying dividends to the creditors.*

*Note 4: For a non-summary case (where the bankrupt's assets exceed \$200,000), the provisional trustee holds a creditors' meeting to consider the appointment of a trustee and a creditors' committee. The committee may give direction to the trustee in the administration of a bankrupt's property.*

**Flowchart of winding-up procedures**



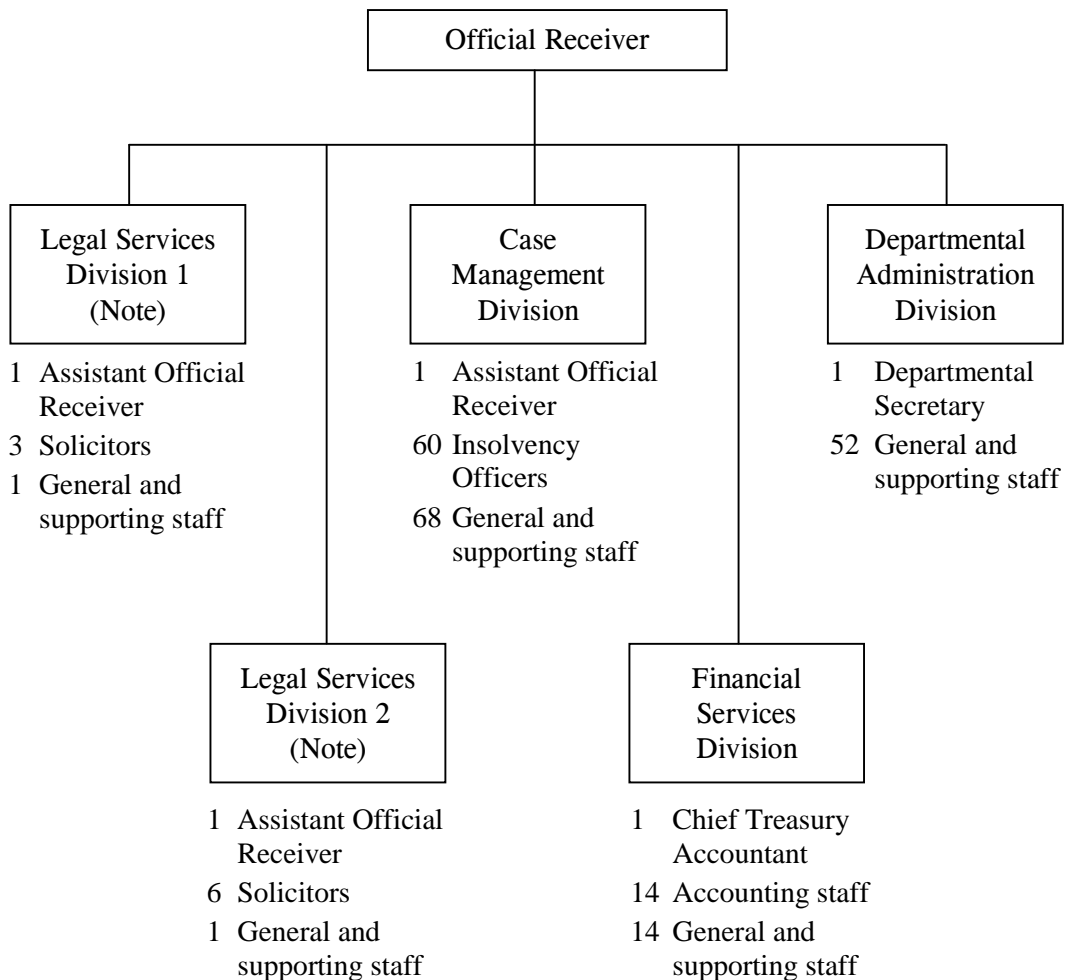
Source: ORO records

Note 1: A petition may be presented by the insolvent company or its creditors. The Financial Secretary or a statutory regulatory body (e.g. the Securities and Futures Commission) may also present the petition if it is in the public interest to do so.

**Appendix B**  
(Cont'd)  
(paras. 1.3 and  
3.2(a) refer)

- Note 2: On the making of a winding-up order by the court, the Official Receiver shall become the provisional liquidator if no other person is appointed by the court. The provisional liquidator shall take possession of the wound-up company's assets. The Official Receiver as provisional liquidator may appoint any qualified person to act as provisional liquidator if the company's assets are unlikely to exceed \$200,000 (summary case).*
- Note 3: For a summary case, the provisional liquidator shall apply to the court for a summary procedure order and becomes the liquidator. A liquidator's duties include realising a wound-up company's assets and paying dividends to the creditors.*
- Note 4: For a non-summary case (where the wound-up company's assets exceed \$200,000), the provisional liquidator holds meetings of creditors and contributories (e.g. shareholders of the wound-up company) to consider the appointment of a liquidator and a committee of inspection. The committee may give direction to the liquidator in the administration of a wound-up company's assets.*

**Official Receiver's Office  
Organisation chart  
(31 December 2011)**



Source: ORO records

Note: Legal Services Division 1 is responsible for providing in-house legal advice on the administration of insolvency cases. Legal Services Division 2 is responsible for investigating and prosecuting insolvency offenders. For simplicity, they are collectively referred to as the Legal Services Division in this Report.

Remarks: As at 31 December 2011, the ORO had an establishment of 225 staff.

**Unreleased insolvency cases  
(2000 to 2011)**

<b>Year end</b>	<b>Unreleased insolvency cases on release programme</b>		
	<b>Winding-up cases</b>	<b>Bankruptcy cases</b>	<b>Total</b>
2000	623	1,762	2,385
2001	433	1,247	1,680
2002	529	6,566	7,095
2003	586	24,686	25,272
2004	529	38,426	38,955
2005	533	46,749	47,282
2006	241	53,823	54,064
2007	259	59,952	60,211
2008	266	67,965	68,231
2009	272	74,611	74,883
2010	243	84,293	84,536
2011	267	85,348	85,615

*Source: ORO records*

**Acronyms and abbreviations**

Audit	Audit Commission
FSTB	Financial Services and the Treasury Bureau
HKICPA	Hong Kong Institute of Certified Public Accountants
IVA	Individual voluntary arrangement
ORO	Official Receiver's Office
PAC	Public Accounts Committee
PIP	Private insolvency practitioner