

# Report No. 58 of the Director of Audit — Chapter 5

## PROVISION OF INSOLVENCY SERVICES

### Summary

1. The Official Receiver's Office (ORO) is responsible for providing insolvency services pertaining to the bankruptcy of individuals and the compulsory winding-up of companies. The work includes the in-house management of insolvency cases when the Official Receiver acts as the trustee (for bankruptcy cases) or liquidator (for winding-up cases), and the management of schemes for outsourcing insolvency cases to private insolvency practitioners (PIPs). As at 31 December 2011, the ORO had an establishment of 225 staff. The Audit Commission (Audit) has recently conducted a review of the ORO's provision of insolvency services.

#### **In-house management of insolvency cases**

2. *Summary procedures for small insolvency cases.* Both the Bankruptcy Ordinance (Cap. 6) and Companies Ordinance (Cap. 32) have provisions for applying summary procedures to small insolvency cases (those with realisable assets within \$200,000 — summary cases) with a view to saving expense and simplifying procedures. In 1985, the limit for applying summary procedures was increased from \$10,000 to the present level of \$200,000 to enable the ORO to use summary procedures in a greater number of cases so as to reduce its workload. Audit noted that, over the past 10 years, the number of non-summary cases (those with realisable assets exceeding \$200,000) had increased from 117 (1% of all insolvency cases) in 2001 to 1,131 (12%) in 2010. *Audit has recommended that, with the lapse of 27 years since 1985, 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.*

3. *Asset search and realisation.* After appointment as the trustee, the ORO is required to search, take possession of and realise the bankrupt's assets. The ORO charges fees on the assets realised. In a sample check, Audit found that: (a) very often, the ORO relied on the bankrupts' declared information in conducting land searches. There was a risk that any bankrupts' undeclared properties could not be detected; (b) for some 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 could not be detected; (c) there was room for improvement in conducting additional searches for other types of undeclared assets of the bankrupts; and (d) in one creditor-petitioned case, the ORO's land search revealed that the creditor had a memorandum of charge registered against the bankrupt's property before presenting the bankruptcy petition. The ORO realised the bank balances of the bankrupt and charged fees thereon. Subsequently, upon the bankrupt's applications, the court ordered the annulment of the bankruptcy order (on the grounds that the debts had been fully secured) and remission of part of the ORO fees. *Audit has recommended that the Official Receiver should: (a) strengthen searches for undeclared assets and previous undervalued transactions of bankrupts; (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) conduct a review to see whether there is room for improvement in the management of bankruptcy cases.*

4. ***Investigation of bankruptcy offence and misconduct.*** 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 there is prima facie evidence of a breach of the law, the case officers are required to pass the case to the ORO's Legal Services Division for consideration of taking prosecution action. The ORO has issued a circular reminding the case officers of the limitation period for summary prosecution of a bankruptcy offence. If in the course of investigation, the bankrupt's conduct is found to be unsatisfactory, the ORO may apply to the court to suspend the discharge of the bankrupt (who would otherwise be automatically discharged four years after the bankruptcy order). In a sample check, Audit found that: (a) there were delays in referring two cases of suspected bankruptcy offence to the Legal Services Division for consideration of taking prosecution action; and (b) of two cases of unsatisfactory conduct of the bankrupts, only one case was referred to the Legal Services Division for consideration of raising an objection to the discharge of the bankrupt. There was no documented reason why the other case was not dealt with in a similar manner. *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) apply a consistent standard in referring cases to the Legal Services Division for consideration of taking enforcement action against a bankrupt's misconduct; and (c) document the reasons for not raising an objection to the discharge of a bankrupt where there are indications that his conduct is unsatisfactory.*

5. **Quality management assessment.** To ensure the quality of the services delivered, the ORO has put in place a quality management assessment whereby its Chief Insolvency Officers would conduct random checks of the insolvency cases handled by their staff. Audit has found that: (a) while the target number of quality management checks was reduced from 280 cases in 2001 to 120 cases from 2007 onwards, 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; and (b) there is room for improvement in the ORO's method of selecting cases for checking. *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.*

6. **Unreleased insolvency cases.** After realising all the assets of the insolvent and distributing the final dividend for an insolvency case, the ORO can apply to the court for a release order which will discharge the ORO's liability from acting as the liquidator or trustee. Audit found that the number of unreleased cases had increased from 2,385 in 2000 to 85,615 in 2011. *Audit has recommended that the Official Receiver should expedite action on applying for release orders for these insolvency cases.*

### **Outsourcing of insolvency cases**

7. The ORO operates four outsourcing schemes, viz: (a) Panel A scheme for non-summary winding-up cases; (b) Panel T scheme for summary winding-up cases; (c) bankruptcy case scheme for debtor-petitioned (i.e. the petition for a bankruptcy order is presented by the debtor) summary bankruptcy cases; and (d) preliminary examination scheme (for interviewing the bankrupts and examining their submitted questionnaires) for those debtor-petitioned bankruptcy cases handled by the ORO.

8. **Admission of PIPs under Panel A scheme.** For administering Panel A scheme, the ORO has set up an Approval Committee. From 2002 to 2005, the number of Committee meetings held fell short of the stipulated frequency. As a result, 17 new applications for admission to the scheme received in 2003 and 2004 had to wait for 9 to 22 months before they were considered by the Committee in September 2005. In May 2008, the ORO set up a working group to review the scheme as the admission requirements (mostly laid down since 1996) might be outdated. Up to December 2011, the review had not been finalised. *Audit has recommended that the Official Receiver should: (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; and (b) expedite action on the review of Panel A scheme with a view to implementing any necessary improvement measures as soon as possible.*

9. **Monitoring of PIPs' performance.** The ORO has implemented measures (including the conduct of quality checks) for monitoring the PIPs under the four outsourcing schemes. Audit found that: (a) for the preliminary examination scheme, the quality checks were not conducted evenly throughout the contract period (for the 2008-10 and 2010-11 contracts); (b) the ORO did not conduct further checks or take regulatory action on two PIPs under the preliminary examination scheme who had repeated delays in interviewing the bankrupts and submitting preliminary examination reports; and (c) in three cases, the PIPs with unsatisfactory past performance were reappointed under new contracts. Their performance after the reappointment continued to be unsatisfactory. *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.*

10. **Audit of accounts submitted by PIPs.** All PIPs when acting as the liquidators or trustees are required to submit accounts of receipts and payments to the ORO (twice a year for liquidator accounts and once every two years for trustee accounts). The ORO has laid down requirements that these accounts shall be preliminarily checked for content and accuracy, and selected for field audit. Audit examination revealed that: (a) as at October 2011, there were 3,792 overdue accounts with 1,334 of them overdue for over nine months; (b) as at December 2011, the ORO had not conducted preliminary checking of 1,139 accounts of non-summary cases and field audit of 257 accounts. The ORO had drawn up an action plan for clearing the backlog within 23 months; and (c) the ORO had not maintained statistics to monitor whether there were delays in conducting preliminary checking of the accounts of summary cases. In January 2012, the ORO informed Audit that it had started to enhance its computer system to monitor these accounts. *Audit has recommended that the Official Receiver should: (a) urge the PIPs concerned to submit the overdue accounts; (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) take measures to improve the timeliness in conducting preliminary checking and field audit; and (d) closely monitor the implementation of the action plan for clearing the backlog of accounts pending preliminary checking and field audit, and the computer system enhancement for monitoring the checking of the accounts.*

11. **Review of resource deployment.** In line with the recommendations of a consultancy study of 2002 that the ORO should be more a regulator than dealing with insolvency cases, the ORO has implemented two outsourcing schemes to reduce its in-house bankruptcy casework since 2003 (see para. 7). Up to December 2011, the ORO had not reviewed its resource deployment to focus more on its regulatory function in the light of the decrease in its casework. Meanwhile, there was a backlog in some of the ORO's regulatory work (see para. 10). *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.*

## **Fees and charges**

12. In line with the “user pays” principle, the ORO charges fees for providing various insolvency services. 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 Chapter 5 of the Director of Audit’s Report No. 34 of February 2000, Audit drew attention to the ORO’s cost recovery rate, which was 67% only for 1998-99. In October 2000, the Administration informed the Public Accounts Committee (PAC) of the Legislative Council that the issues of cost recovery rate and the fee structure would be looked into in a consultancy study to review the role of the ORO (see para. 11).

13. *Cost recovery rate.* Audit examination revealed that from 2000 to 2010, the ORO had conducted five fees and charges reviews. According to the ORO’s costing statements for the 2009 and 2010 reviews, the ORO had continuously achieved cost recovery rates exceeding 100% from 2000-01 onwards. Audit noted that: (a) the PAC was not informed of such reviews and the costing results; (b) while the costing results of the 2009 and 2010 reviews showed that there were operating surpluses in the past years, 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%; and (c) in 2011, the ORO commenced another fees and charges review. As of February 2012, the review had not been finalised. *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; (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.*

14. *Costing exercise for fees and charges review.* 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 room for improvement in their preparations. *Audit has recommended that the Official Receiver should step up checking of the costing statements and take measures to improve the compilation of cost estimates.*

## **Individual voluntary arrangement**

15. An individual voluntary arrangement (IVA) is an alternative to bankruptcy whereby a debtor makes a repayment proposal to the court and his creditors. If approved, it will be binding on all creditors. The advantages of an IVA are that the debtor will be free from legal restrictions under the Bankruptcy Ordinance and the creditors may expect better repayment from the debtor. To implement an IVA, the Bankruptcy Ordinance requires the debtor to find a person (an accountant or a solicitor) to act as a nominee.

16. ***Encouraging greater use of IVAs.*** Since 1999, the ORO has stated in its Controlling Officer's Reports that it will continue to encourage greater use of IVAs by debtors. After a period of steep growth from 2002 to 2004, the use of IVAs ranged between 9% and 16% from 2005 onwards. Audit notes that the ORO's participation in promotional activities on IVAs (e.g. seminars and talks) 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. *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.*

17. ***Administering the IVA register.*** The ORO has a statutory duty to maintain a register of approved IVAs (based on reports submitted by nominees) for public inspection. Audit found that, of the 17,092 reported IVA cases as at October 2011, in 476 cases (3%) the nominees had delays in submitting reports and in 11,064 cases (65%) the ORO had taken more than seven days to update the IVA register after receiving the reports. *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; and (b) take measures to improve the timeliness in updating the IVA register.*

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

18. The Administration agrees with the audit recommendations.

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