

**For discussion
on 6 June 2005**

Legislative Council Panel on Financial Affairs

Write-off of a Judgement Debt

Purpose

The purpose of this paper is to consult Members on a proposal to write off an irrecoverable debt of \$16,797,419.83, inclusive of costs of action and interest calculated up to 24 June 2005^{Note}, owed to the Government by an auctioneer hired by the former Government Supplies Department (GSD) (now the Government Logistics Department (GLD)) to conduct commercial disposal of unserviceable or obsolete government stores and confiscated goods.

Background

2. A debt of \$16,797,419.83 owed to the Government by the Hong Kong Auctioneers and Estate Agency Ltd. (HKAEAL), a wound up company, has been found to be irrecoverable. The amount comprises a judgement sum of \$10,742,838.17, being principally the default payments of sale proceeds from disposal of unserviceable or obsolete government stores and confiscated goods, costs of action and interest of \$6,059,581.66, calculated up to 24 June 2005, less \$5,000 in contract deposit.

Justification

Contract for provision of auctioneer service

3. Since the 1970s, through repeated success in competitive bidding organised every two years, HKAEAL had been GSD's contracted auctioneer for the sale of unserviceable or obsolete government stores and confiscated goods. In 1996, HKAEAL was again awarded a contract for providing the service for two years from 1 April 1996 to 31 March 1998. The contract was subsequently extended for five months and expired on 31 August 1998.

^{Note} As we plan to submit the proposal of write-off to the Finance Committee (FC) for consideration on 24 June 2005, the amount of interest is calculated up to the same date.

4. In accordance with the contract, HKAEAL was to conduct the auctions and to collect the proceeds for the Government. Except for some delays in payments of the auction proceeds to Government, HKAEAL's performance had been satisfactory. To protect the Government's interest and to address the late payment problem, GSD tightened the terms of the contract in 1996 by introducing a late payment clause. This imposed on the company an interest charge of 1% above the prime rate on all outstanding amounts which had not been paid to the Government within 14 days of the relevant auctions.

Default in payment

5. In August 1998, GSD discovered that of the 58 auctions conducted during the period of the contract from 1 April 1996 to 31 August 1998, HKAEAL had only reimbursed to the Government the proceeds from the first 43 auctions. The amount in default, inclusive of net sale proceeds and interest for late payments, was about \$15.8 million at the time. This problem, however, was not brought to the attention of GSD's senior management until after the end of the contract.

Actions taken to recover the outstanding payments

6. GSD took immediate action to recover the debt. It had several meetings with the Managing Director of HKAEAL both to press for payment and to assess HKAEAL's and its Managing Director's financial situation. Eventually, after much negotiations and efforts, a Deed of Settlement was concluded with the Managing Director on 31 March 1999 with a schedule of payment for full settlement of the outstanding amounts. Unfortunately, after making the initial several payments totalling \$6 million towards the debt, the company and the Managing Director were unable to deliver further. In the circumstances, GSD, through the Department of Justice, instituted legal proceedings in the High Court for recovery of the remaining amount. In November 1999, the Court ordered that HKAEAL and its Managing Director paid the Government the sum of \$10,742,838.17 plus interest from the date of judgement. The Court also awarded costs to the Government.

7. Despite the court order, HKAEAL failed to settle the judgement debt ordered by the Court. In June 2000, a winding-up order was then made against HKAEAL. The Official Receiver was appointed liquidator. Meanwhile, however, the Managing Director left Hong Kong in February 2000 and has not returned since then. Upon the application of the Official Receiver, a Warrant of Arrest against the Managing Director was granted by the Court in June 2000. In addition, investigations and searches were made

to locate the Managing Director and to search his assets in countries where he had previous connections. Unfortunately, all these attempts were futile and the Warrant of Arrest was discharged in March 2004. While the liquidation process has yet to be fully concluded, the Official Receiver has advised that it is unlikely that any dividends would be paid. We therefore consider that the debt has become irrecoverable and should be written off.

Internal investigation and disciplinary actions taken

8. In parallel with the actions taken to recover the debt, GSD has conducted internal investigation into the case. The Independent Commission Against Corruption was also invited to look into the possibility of corruption. These investigations revealed that the case did not involve fraud or corruption but there were inadequacies in the performance of some staff in performing their duties.

9. Formal disciplinary proceedings were instituted against a Senior Accounting Officer. He was punished with a severe reprimand, together with a fine equivalent to reduction in salary by two increments for 12 months and a caution of removal from the service in the event of further misconduct. In addition, several other officers who were involved, namely, one Accounting Officer I, one Principal Supplies Officer, two Chief Supplies Officers and one Senior Supplies Officer were given either verbal or written warnings having regard to the division of responsibilities and the degree of their involvement in the matter.

Remedial actions taken

10. To forestall recurrence, GSD has taken various improvement measures to guard against late payments. Between 1998 and 2002, the auctioneer was required to advise the department of the gross auction value not later than one working day after the auction date, based on which the Accounts Section would immediately issue demand notes to the auctioneer for the gross sale proceeds. Demand notes outstanding by the due dates, if any, were immediately reported to the senior management and warning letters would be issued to the auctioneer in the event of late payments which could lead to termination of contract. No late payments by the auctioneer were found ever since. To further strengthen controls, GSD (now GLD) has taken over the auction function since November 2002. The auctions are now held with an auctioneer hired to provide the professional service of conducting the auction only. The auctioneer is no longer responsible for collecting any auction proceeds from the successful bidders who are required to pay the proceeds directly to the Government by 4:30 p.m. on the auction day. A release note is only issued to the successful bidders upon

confirmation of receipt of the proceeds or upon clearance of the cheque. The arrangements are considered satisfactory.

Proposal

11. The total amount proposed to be written off is \$16,797,419.83, broken down as follows-

<i>Item</i>	<i>\$</i>
Judgement sum	10,742,838.17
Costs of action	189,962.00
Interest calculated from date of judgement up to 24 June 2005	5,869,619.66
Less contract deposit retained	(5,000)
Total:	16,797,419.83

12. For cases not involving fraud or negligence, the Financial Secretary (FS) is empowered under section 38 of the Public Finance Ordinance (Cap. 2) to write off losses of public moneys, stores, etc. without financial limit. For cases involving fraud or negligence, FS may only exercise his power of write-off subject to such conditions, exceptions and limitations FC may specify. The current limit of delegated authority is \$500,000 in each case, or in respect of any one cause. Since staff negligence is involved in the current case (paragraphs 8 and 9 above) and the amount exceeds the financial limit, we need the approval from FC to write off the irrecoverable debt. Accordingly, we intend to seek FC approval for writing off the debt at its meeting on 24 June 2005.

Advice sought

13. We welcome Members' views on the above proposal.

Financial Services and the Treasury Bureau
May 2005