

**INSPECTOR-GENERAL
PRACTICE STATEMENT NO. 11**

**Monitoring and Inspection
of Bankruptcy Trustees
and
Debt Agreement Administrators**

Release Date 1 September 2008

Contents	Page no
INTRODUCTION	3
INSPECTION OF ADMINISTRATIONS & SYSTEMS.....	3
<i>Fraud Control Issues</i>	<i>3</i>
<i>Arranging the Inspection</i>	<i>4</i>
<i>Determining the Sample and Scope of the Inspection.....</i>	<i>5</i>
<i>Undertaking the inspection</i>	<i>5</i>
<i>Reporting of non-compliance.....</i>	<i>6</i>
<i>Finalising the Inspection.....</i>	<i>7</i>
<i>Possible action when breaches are identified.....</i>	<i>8</i>
ATTENDING MEETINGS OF CREDITORS	8
<i>Introduction.....</i>	<i>8</i>
<i>The legislative framework</i>	<i>9</i>
<i>Criteria for attending</i>	<i>9</i>
General criteria	9
Trustee specific criteria	9
Creditor specific criteria	10
Debtor specific criteria	10
<i>Prior to the meeting</i>	<i>10</i>
<i>At the Meeting</i>	<i>11</i>
<i>Post-Meeting</i>	<i>11</i>
CONCLUSION.....	11

Introduction

1. The regulatory responsibilities of the Inspector-General in Bankruptcy are aimed at ensuring high national standards of bankruptcy practice and procedure. These functions are undertaken by ITSA Regulation, which oversees registered trustees in private practice, ITSA's trustee function (the Official Trustee), registered and unregistered debt agreement administrators, and solicitors who act as trustees in personal insolvency agreements. ITSA Regulation acts independently from the Official Trustee and reports directly to the Chief Executive and Inspector-General in Bankruptcy.
2. One strategy employed by ITSA Regulation, as delegate of the Inspector-General, is to monitor the standard of bankruptcy trustees and debt agreement administrators and their administrations through an annual inspection program. This may include for example:
 - An annual inspection of administrations, systems and practices;
 - Attending some meetings of creditors;
 - Reviewing the quality of trustee decisions;
 - Targeted or strategic investigation;
 - Reviewing the complaints made against the practitioner in the period; and/or
 - Surveying debtors and creditors.
3. This document articulates the Inspector-General's practices and expectations when monitoring practitioners through the annual program of inspection of administrations, systems and practices and attending meetings of creditors.

Inspection of Administrations & Systems

4. The purpose of ITSA Regulation's annual inspection program is to examine the quality of administration by practitioners with particular emphasis on:
 - (i) Compliance with legislation and common law requirements;
 - (ii) Proper performance of statutory and fiduciary duties and functions in accordance with legislation and standards;
 - (iii) Financial records, billing and money handling practices; and
 - (iv) Control and system weaknesses and other areas of risk.
5. This is a pro-active process aimed at providing constructive feedback to practitioners to improve compliance and practice. However it should be recognised that on occasion issues may be identified that warrant further investigation and the adoption of more reactive strategies, including disciplinary proceedings, to obtain compliance and remedial action.

Fraud Control Issues

6. An important benefit of this program is that, while an inspection of a sample of administrations cannot be expected to identify all instances of defalcation, it is a valid preventative control to minimise the risk of fraud.
7. Accordingly ITSA Regulation has inbuilt into its inspection program tests of the systems and controls of trustees. The following aspects of ITSA Regulation's annual inspection program should be noted:

- The ITSA Regulation file sample is computer generated and, whilst targeted to higher risk estates, includes a sizable computer based random sample. As a consequence any file, including one inspected in previous periods, could be selected.
 - The random sample can include estates where no assets were shown as realised and no funds recorded and therefore include estates where there may have been deliberate omission.
 - Estates with assets, contributions or dividends are closely examined and the transactions followed through the course of the administration to final payments/dividend. This may well include tracing a series of cheques to the account to which they are presented.
 - On a sample basis contributions may be reconciled with the bankrupt's payment records.
 - ITSA Regulation may contact both creditors and debtors on a sample basis (and in some cases banking institutions) to verify transactions and that claims are properly recorded and authentic.
 - Practitioners will be required to reconstruct any files unable to be located and ITSA Regulation will treat the inability to do so, within reasonable time, as a serious breach of duty.
8. As an added deterrent to possible employee fraud it is the Inspector-General's expectation that practitioners will inform their employees of these aspects of the ITSA Regulation program.

Arranging the Inspection

9. ITSA Regulation aim to provide practitioners with at least 7 days notice of the date of its attendance for inspection. A mutually convenient date and time to inspect will be co-ordinated with the practitioner. At this time the practitioner will be requested to complete and provide either a summary of their systems and controls or an update of changes since the date of last inspection.
10. As a control to minimise the incidence and risk of fraud, ITSA Regulation's policy regarding the timing of notice provided to trustees and debt agreement administrators is to provide details of the specific files to be inspected 24 hours before the commencement of the inspection. If ITSA Regulation identifies older files that may be archived, 48 hours notice will be provided to allow for file retrieval.
11. This practice is used with all practitioners including the Official Trustee. ITSA Regulation previously identified fraud where a longer time frame adopted provided a trustee's employee the time to remove, alter and forge records prior to the inspection.
12. ITSA is required to comply with the Occupational Health and Safety Legislation in providing its employees with a healthy and safe work environment. With this and to ensure both privacy and efficiency in undertaking the inspection practitioners are requested to provide either an office with a workstation and office chair, or a workstation and chair with some privacy, both with access to a power point outlet.

Determining the Sample and Scope of the Inspection

13. In determining the size of the sample of files to inspect, ITSA Regulation will undertake a risk assessment of the practice. Practitioners are rated in accordance with the quality of their systems and controls and the prior quality of practices and procedures.
14. An evaluation is undertaken of a practitioner's systems and controls in the first year of inspection and details maintained on the practitioner's file. During the second and third year of inspection the evaluation is updated. During the fourth year of inspection a complete re-evaluation will be undertaken to ensure any significant changes have been documented and included in the assessment.
15. Key elements of the practitioner's risk assessment that will be used to determine the size and scope of the sample include:
 - The structure of firm
 - The qualifications and experience of support staff
 - An assessment of systems and controls
 - Their history of justified complaints
 - Their prior inspection results
 - The quality of prior decisions subject to Inspector General review (for trustees only).
16. The rating defines the minimum number of administrations to be sampled and will also be used to identify issues or the attributes BR wishes to more closely examine.
17. The second element of the sampling is the computerised selection of the files to inspect. ITSA Regulation's methodology is based on a number of risk attributes. For example attributes in a Part X personal insolvency agreement or a Part IV bankruptcy might include:
 - Estates where the extent of assets realised is greater than a certain amount;
 - Estates where the percentage of remuneration is greater than a certain amount;
 - Estates where dividends have been paid;
 - Estates with high level of liabilities; and/or
 - Part X's with a low % dividend;
18. While the Part IX sample is largely random in nature some attributes may be examined. For example ITSA Regulation will include in its inspection sample administrations where:
 - the debt agreement proposal (DAP) has been rejected or cancelled by ITSA's Debt Agreement Service (DAS);
 - practice queries were raised on processing of the DAP by the DAS;
 - variations and terminations have occurred; and
 - the level of fees is outside normal ranges.
19. It should be noted that in every inspection there will also be some files which will be randomly chosen. These may display no identifiable attributes and may include estates previously examined.

Undertaking the inspection

20. The inspection commences with an entrance interview with the registered practitioner. This interview is an opportunity for the practitioner to discuss matters or technical areas of interest

with the ITSA Regulation inspector, particularly if there is an area where the practitioner seeks additional feedback. The practitioner's response to the systems and controls questionnaire will also be discussed at the entrance interview. It is therefore important that the practitioner is present at this interview.

21. It is preferable that queries be informally discussed and, where possible, clarified with the practitioners or their nominee during the inspection. To minimise any disruption to workflow the practitioner should outline the protocols they require of ITSA Regulation, including who ITSA Regulation inspectors should contact for clarification of issues during the interview. If the practitioner feels this may be too disruptive, arrangements can be made to collate queries for discussion at the exit interview for response either at that time or later.
22. ITSA Regulation inspectors are required to maintain a professional, independent and courteous approach. If during the inspection a practitioner is concerned as to the conduct of the officer or the inspection process they should raise these concerns directly either with the Regional ITSA Regulation Business Manager or the Regulation and Enforcement National Manager.
23. If a possible error is found, (see later sections "Reporting of non-compliance"), further testing may be carried out to determine whether the error is a one-off occurrence, a systematic problem or identifies a weakness in supervision or training.
24. ITSA Regulation will inspect each estate or administration for compliance. It will then compile and analyse the results to assess whether there are systemic issues or control weaknesses.
25. The inspection at the practitioner's office will be completed by way of exit interview. Feedback will be given on the quality of administration inspected. Any preliminary errors and observations noted and discussed throughout the inspection will be raised at the exit interview and the practitioner given opportunity to comment. ITSA Regulation will also provide comments on any issues identified by the practitioner at the entrance interview plus any issues of best practice where greater efficiencies could be achieved.
26. Records are made and retained of discussions and comments made both at the entrance and exit interviews.

Reporting of non-compliance

27. In providing feedback and to make overall conclusions as to the standard of practice any identified areas of non compliance, referred to as errors, are compiled and reported based both on the level of seriousness (category) and their descriptive nature.
28. If any breach or non compliance with the law is identified ITSA Regulation will consider:
 - (a) the nature of the breach;
 - (b) the seriousness of the effect of a failure to comply, including the impact on a particular estate or individual; and
 - (c) whether the practitioner has previously failed to comply and the practitioner's performance history.
29. The majority of practitioners are willing to comply, and view the inspection program as an opportunity to obtain feedback on the quality of administration. However there is an expectation that practitioner's who regularly fail to comply with the Bankruptcy Act and

Regulations without a reasonable explanation, or who regularly diverge from acceptable practice or their behaviour/conduct brings the integrity of the profession in disrepute will be subject to disciplinary action.

30. To assist in assessing the seriousness and relevant regulatory response and alert practitioners of the issues and possible repercussions, non-compliances are classified as either Category A, B or C depending on the level of seriousness.

Category A

These are very serious errors or breaches requiring immediate attention and include fundamental breaches and lack of controls that are likely to bring into question the integrity of the system. These include any repeat occurrences of serious breaches identified in previous inspections as category B errors. These matters will generally give rise to legal action, referral to fraud investigators, considering whether the practitioner should have their registration cancelled under sections 155H, 186K or 186L or at least have their registration suspended or conditions placed on it. In the case of a solicitor controlling trustee or unregistered debt agreement administrator this would result in action which could result in them being declared ineligible to act.

Category B

Serious or systemic errors that will have a material impact on the administration and require timely remedial action. The practitioner should be counselled and timely remedial action taken. These include where in prior inspections breaches were identified and either not remedied or repeat errors are made in the same area.

Category C

One off practice or procedural errors and non compliance errors that are not systemic and don't have a significant impact on the administration, dividend or creditors, debtor's rights or system integrity but should be brought to the attention of the practitioner and monitored.

Finalising the Inspection

31. After attending the offices of the practitioner ITSA Regulation may write to a sample of creditors in administrations identified during the inspection where the practitioner's records show a dividend has been paid to creditors. This verification is to ensure that the creditors are bona fide and that they received and banked dividend cheques. ITSA Regulation may also sample and seek verification from debtors as to the amount paid to the practitioner.
32. Once information is complete the practitioner will be provided with a draft inspection report seeking comments on any issues raised. The report will outline the overall results of the inspection; any provisional errors or systemic issues as discussed at the exit interview; any observations of significance discussed at the exit interview; and any remedial action that may be required. In cases where serious or systemic issues appear to have been identified the report will be reviewed and issued by the Regional ITSA Regulation Business Manager responsible.
33. The practitioner's response is generally expected within 14 days. The inspection is completed once the practitioner either responds to the inspection report or elects not to respond.

34. The practitioner's risk assessment rating is then updated for future inspections and ITSA Regulation will monitor any specific administrations requiring remedial action.
35. The Inspector-General is bound by the Privacy Act and will maintain the confidentiality of individual inspection results unless Privacy Act exceptions apply. Exceptions allowed for under Privacy legislation of where ITSA Regulation is able to provide specific details to others include: where the information has been obtained for a specific purpose and allowed for under Bankruptcy legislation, (an example of this would be provision of information to Parliament); where there has been consent by the practitioner; information required by a law enforcement agency; and where the information has become public knowledge, for example through publishing of a Court or AAT judgment.

Possible action when breaches are identified

36. There is a range of strategies available to ITSA Regulation should it determine that a breach of legislation, duty or other non compliance has occurred (see IGPS 1- Regulatory Framework). These relate to all practitioners and include.
 - (i) Education – making practitioners aware of systemic problem areas and the correct practice or law individually and collectively;
 - (ii) Individual feedback– by far the most effective means to achieve timely remedial action;
 - (iii) Counselling of the practitioner;
 - (iv) Change in the risk classification of a practitioner. This will lead to a larger sample of files being selected for future annual inspections;
 - (v) Formal investigation and reporting under section 12, for example, to creditors, police or professional bodies such as IPA, ICAA, CPA or Law Council;
 - (vi) Special Audit of accounts;
 - (vii) Imposition of penalties for Realisation and Interest Charge breaches;
 - (viii) Litigation; and
 - (ix) Involuntary cancellation or registration proceedings (or illegibility proceedings in the case of unregistered debt agreement administrators and solicitors who act as controlling trustees). See also IGPS 8 and IGPS 9 dealing with involuntary cancellation of registration.

Attending meetings of creditors

Introduction

37. ITSA Regulation, as delegate of the Inspector-General, attend a sample of meetings of creditors in both Part X matters and section 73 proposals for all trustees involved, as part of its inspection program, irrespective of whether there are matters warranting attendance by ITSA Regulation.
38. Attendance at a sample of meetings provides ITSA Regulation with an opportunity to monitor and report on the standard of controlling trustees in Part X administrations and trustee meeting practices generally. It also provides an effective and efficient method of monitoring debtor's Part X proposals and addressing creditor queries and perceptions.
39. In addition ITSA Regulation examines both section 189A and section 73(2) reports and if it has any queries or concerns will discuss matters with the trustee and may attend the meeting

taking an active role if needed. Often issues are clarified or problem areas rectified before creditors are asked to vote at the meeting.

40. Irrespective of whether a criteria detailed below is evident or not, as part of ITSA Regulation's normal inspection program, where trustees are conducting meetings, ITSA Regulation will endeavour to attend not less than 1 meeting for every trustee each year.
41. The issues and performance of trustees in Part X matters generally is analysed by the Inspector-General and reported to Parliament annually.
42. The following documents the criteria that ITSA Regulation is to utilise in determining which creditors' meetings are attended and the protocols and processes to be used.
43. The term "trustee" is utilised in this practice statement to represent registered trustees, Official Trustee and solicitor controlling trustees.

The legislative framework

44. Subsection 12(4) of the Act provides authority for the Inspector-General to attend and participate in meetings of creditors. This subsection states:

"The Inspector-General:

- (a) is entitled to attend any meeting of creditors held under this Act; and*
- (b) subject to section 64ZA, is entitled to participate in any such meeting as the Inspector-General thinks fit."*

Criteria for attending

General criteria

45. ITSA Regulation may attend where there appears to be an inherent risk to the credibility of the personal insolvency system posed by the administration in which the meeting is being held. This would be the case where:
 - (i) It is suspected that creditors have not been properly informed, either because the debtor has not provided complete or accurate information or the trustee's report is deficient;
 - (ii) The debtor is high profile with sizeable debts and there is public interest; or
 - (iii) ITSA Regulation has concerns as to the validity of a creditor's claims and the creditor can affect the outcome of the meeting.

Trustee specific criteria

46. Meetings may also be attended when:
 - (i) The trustee has a history of poor standard reports and meeting practices or is inexperienced in chairing meetings;
 - (ii) The trustee is inexperienced and has not conducted a creditors' meeting in the last 12 months;
 - (iii) The debtor's statement of affairs, or information from some other source, indicates:

- the debtor may have been involved in a high income occupation such as doctor or barrister but displays little in the way of assets or income and the offer to creditors is relatively small;
- antecedent transactions; or
- the debtor may have recently possessed substantial income, assets or that they controls trusts or private companies.

AND the s189A report contains no or inadequate discussion of those issues,

AND the trustee has been requested to provide further advice but a satisfactory response has not been provided.

Creditor specific criteria

47. Meetings may also be attended when:

- (i) A creditor lodges a complaint prior to the meeting; or
- (ii) If there are related party creditors whose vote can effect the outcome or if there is a high number of creditors who may vote but don't wish to participate in a dividend particularly where there is a substantial creditor likely to be effected.

Debtor specific criteria

48. Meetings may also be attended when:

- (i) The debtor has been bankrupt or entered into a Part IX or Part X twice or more in the 10 years preceding the current s188 authority;
- (ii) The debtor's creditors exceed \$1M and their proposal would provide an insignificant return; or
- (iii) ITSA Regulation has reason to suspect that full and true disclosure of information was not made.

49. In regions where a large number of meetings are held per annum it may not be possible to attend all meetings exhibiting one or more of the above criteria. In these circumstances ITSA Regulation will exercise judgement as to which meetings are attended.

Prior to the meeting

- 50. Attendance is likely to be in person but may at times occur through teleconference, if those facilities are available.
- 51. ITSA Regulation will inform the controlling trustee or trustee of the meetings it will be attending prior to the meeting. Where possible at least 24 hours notice will be given.
- 52. ITSA Regulation will consider whether the issues identified warrant attendance at the meeting or can be resolved through prior discussion (either by telephone, email or direct meeting) and action. ITSA Regulation will consult with the trustee and raise queries and concerns privately prior to the meeting if possible. Every attempt will be made to resolve these issues prior to the meeting. Intervention may lead to a supplementary report or clarification of contentious issues at meeting.

At the Meeting

53. Usually two ITSA Regulation representatives will attend the meeting although each case will be treated on its merits.
54. Should matters not be addressed to ITSA Regulation's satisfaction, the ITSA Regulation inspectors may intervene in meetings, raise issues, and may seek clarification from the debtor, the creditor or the trustee.
55. Confrontational and/or adversarial behaviour by parties at the meeting will not result in any reaction from ITSA Regulation at the time of the meeting. However, where appropriate, feedback will be provided at a later opportunity.
56. If questions are to be asked at the meeting by ITSA Regulation, every effort will be made to provide a list of those questions to the trustee prior to the meeting. The aim is not to "ambush" the trustee at the meeting although issues may arise or events occur at the meeting that require immediate ITSA Regulation intervention. This would be the case with non-compliance with the law where immediate remedial action is necessary by the trustee.
57. A record will be made of those cases where the trustee, or their staff, has attempted to hinder ITSA Regulation's proper involvement at the meeting. Consideration will be given to further action if warranted after the meeting.

Post-Meeting

58. As part of ITSA Regulation's educative role, where appropriate, feedback will be provided to trustees on the quality of the meeting processes.
59. Any specific patterns of inappropriate meeting process will be recorded and any requirement for remedial action communicated to the trustee.

Conclusion

60. To contribute to the transparency of decision making in the Australian Public Service this practice statement has outlined the proactive annual inspection and meeting attendance strategies used by ITSA Regulation branch to monitor the quality of registered practitioners operating under the Bankruptcy Act. It has set out what ITSA undertakes to do, the basis of related decisions and what ITSA expects of practitioners in these areas.