RESPONSE TO
CONSULTATION ON
FUNDING THE ACCOUNTING IN BANKRUPTCY 2018-19
ACCOUNTANT IN BANKRUPTCY
Introduction

1. The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents over 21,000 members who advise and lead business across the UK and in almost 100 countries across the world. ICAS is a Recognised Professional Body (RPB) which regulates insolvency practitioners (IPs) who can take appointments throughout the UK. We have an in-depth knowledge and expertise of insolvency law and procedure.

2. ICAS’s Charter requires it to primarily act in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and protect their interests. On the rare occasion that these are at odds with the public interest, it is the public interest that must be paramount.

3. ICAS is interested in securing that any changes to legislation and procedure are made based on a comprehensive review of all of the implications and that alleged failings within the process are supported by evidence.

4. ICAS is pleased to have the opportunity to submit its views in response to the Accountant in Bankruptcy (AiB) consultation on Funding the Accountant in Bankruptcy 2018-19. We shall be pleased to discuss in further detail with the AiB any of the matters raised within this response.

Executive summary

5. The Policy and development function carried out by the AiB in support of the Scottish Government should be transferred to the Scottish Government. Should the Policy and development function not be transferred to the Scottish Government then this should be funded in full from the public purse.

6. Steps should be taken to withdraw the supervision of and investigation of complaints against trustees as a function of the AiB for which there is a regulatory model under the Insolvency Act 1986. This is an unnecessary cost and burden which could be removed thus reducing the resource requirement on the AiB.

7. Non-statutory functions of the AiB should have a clear rationale and agreement of stakeholders prior to being undertaken.

8. Full cost recovery is only appropriate where there is appropriate responsible management and accountability. Full cost recovery is incompatible with income generation being imposed on third parties without alternative providers being available and where large societal principles are at stake.

9. Any fee structure should be designed to ensure that there is no unnecessary drain on the public purse by ensuring that the AiB is not trustee by default but trustee of last resort. It may be necessary in due course to amend legislation to achieve this objective.

10. Cross-subsidy must be considered including funding from DAS.

11. Cross-subsidy must be moderated, ensuring that there is not an unfair burden passed to those providing the subsidy. There must be clear justification for any cross-subsidy including an assessment of the fairness and impact on those affected by the subsidy.

12. The fee for determining a trustee’s remuneration and outlays would benefit from harmonisation across sequestration and trust deeds. A new fee structure of more reflective of the work involved, and indeed differences in approach, to determining remuneration and determining outlays should be considered. For example, it may be more appropriate for the audit fee to be based on 17.5% of remuneration together with 5% of outlays.

13. We would support the provision of interest on overdue debts due to the AiB, but at a rate which is more realistic and commercially sensitive.

14. It may be helpful for a more detailed and independent review on the future of AiB funding to be carried out, providing greater transparency of funding policy and allowing consideration of more radical or innovative funding models to be considered.
Response

15 We welcome the consultation being carried out on how the AiB is funded. The consultation paper issued is unclear on whether this is a consultation on funding for 2018/19 or a consultation with a wider scope and longer timeframe. The consultation title favours a restricted scope whereas paragraph 1 states “This consultation paper seeks views on the right approach to adopt to funding Accountant in Bankruptcy...” which would favour a wider scope.

16 In responding to this consultation, we have therefore considered some of the fundamental principles which may wish to be considered longer term as well as considering the specific proposals to amend fees from 1 June 2018.

17 We are concerned about the lack of clarity over funding within the consultation paper. The paper seems to conflate operating surplus/deficit with funding and income and expenditure. This is either a deliberate attempt to confuse matters or demonstrates a lack of understanding of the financial workings of the AiB, either of which gives cause for concern.

18 For example, paragraph 6 of the consultation paper indicates that the Scottish Government contributed £134,000 of income in 2016/17. That contribution is not shown as operating income in Annex B. £134,000 is the operating deficit (excess of expenditure over income) during the year. The Scottish Government may have provided cashflow funding (the 2016/17 accounts indicate that the Scottish Consolidated Fund provided £732,000) this is not the same as the Scottish Government providing income or public funding of services.

Functions of the AiB

19 How and to what extent the AiB is funded will largely be determined by the functions and work carried out by the AiB. It is therefore somewhat surprising that in consulting on the funding of the AiB that there is no consideration of what functions the AiB is required to carry out. ICAS has raised on several occasions in recent years that it would be appropriate to consider whether the AiB still requires to carry out certain function or indeed whether the functions would be more appropriately carried out by other bodies. For example, we consider that there is a clear conflict of interest in the AiB providing policy and development support for the Scottish Government while acting as a provider of insolvency services. Similarly, the AiB’s supervision of trustees stems from a time prior to the introduction of insolvency practitioner licencing under the Insolvency Act 1986 and is arguably double regulation of the insolvency profession in Scotland.

20 The policy and development function carried out by the AiB would be more appropriate as a direct function of the Scottish Government. It is not appropriate for the costs associated with running the Scottish Government to be funded by debtors and creditors through AiB funding.

21 Even if the function were to remain with the AiB, funding of policy and development should be funded on a full cost basis by the public purse and not subject to funding by debtors and creditors. Annex C of the consultation document sets out the income for the AiB in 2016-17 which shows that no funding was received from the Scottish Government to fund the policy and development functions of the AiB.

22 In recent years the AiB have invested heavily in IT projects. These have delivered systems such as BASYS, ASTRA and DASH. These projects and systems seem to on occasion extend beyond the statutory functions of the AiB. For example, developing IT systems to allow creditors to vote on the protection of trust deeds or to facilitate communications between trustees and creditors are arguably beyond the AiB statutory functions. There are inadequate mechanisms for such developments and spend to be challenged with the result that those bearing the burden of full cost recovery are presented with a fait accompli.

Full cost recovery principle

23 A central tenant of the AiB mission is ‘to provide access to fair debt relief’ (AiB 2017-18 Business Plan). This reflects a social desire by the Scottish Government to ensure that debt relief is available to the people of Scotland where required and is over and above the rights of creditors to take steps to recover amounts through an insolvency process. This is a principle which we support.
The question then is who should pay for policies which benefits society as a whole? There is no right or wrong answer to that question and many funding models exist. It is probably appropriate to recognise that funding should come from a mixture of governmental sources and private sources. The challenge is finding an appropriate balance between funding sources.

We acknowledge the efficiency savings targets set by the AiB in recent years. Over 40% of costs relate to staffing and accommodation costs and a further 37% of costs are directly relational to sequestration activity. A further 10% of costs are identified as non-cash costs. In effect, only 13% of costs are available against which efficiency savings can be made when set alongside the Scottish Government policy of no compulsory redundancies.

The principle of full cost recovery is laudable for public services but must also be recognised as having onerous restrictions. If full cost recovery is to be implemented, then it must also come with responsible management and accountability. Full cost recovery is incompatible with a system where income generation is imposed on third parties without alternative providers being available and where there are large societal principles at stake. Full cost recovery is also incompatible with artificial impediments to cost savings such as no compulsory redundancy policies.

### Funding the AiB as trustee

Paragraph 9 of the consultation paper refers to the “fundamentally important role of the Accountant in Bankruptcy acting as a Trustee of last resort...”. We agree that this is an important role and that there are many reasons why it is appropriate for a trustee of last resort to be available in order that access to debt relief may be obtained by many of the most vulnerable in society.

It is unclear however whether the AiB is being used as a ‘trustee of last resort’ or whether the AiB is perhaps more appropriately characterised as the ‘default trustee’. In 2016/17, the AiB was appointed in 84% of all sequestrations, a rate which has been increasing in recent years. We are not aware of any research having been carried out or statistical analysis undertaken to substantiate that the AiB is being used as a ‘trustee of last resort’.

The true nature of AiB as a bankruptcy trustee provider is important. We are led to understand that the average cost to run a sequestration by the AiB is greater than the income generated (i.e. there is a loss incurred)

There is evidence that the AiB is being used as a ‘default trustee’. For example, HMRC who account for a substantial proportion of creditor petitions will seek the appointment of the AiB in most instances. Many local authorities also appoint the AiB as trustee by default. Overall in 2016/17 the AiB was appointed trustee in 86% of debtor applications and 80% of creditor applications.

The implications of this is that the AiB acts as a direct competitor to the private sector but without the same costs of regulation or commercial requirements. The AiB have stated in evidence to the Economy, Jobs and Fair Work Committee (21 March 2017) that they incur a loss on the majority of creditor sequestration cases although there does not appear to be information available publicly to verify this.

To ensure there is not a drain of the public purse unnecessarily, it is recommended that the fee structure should ensure that there is no incentive for the AiB to be appointed as trustee by default and that the AiB should only be appointed as trustee of last resort. It may be necessary in due course to amend legislation to achieve this objective.

### Audit fee and cross-subsidy

Paragraphs 19-21 of the consultation sets out some background to the audit fee charged by the AiB. The consultation document states “Understandably, private Insolvency Practitioners only take cases where there are likely to be sufficient funds to cover their costs – and there is an argument that it is fair to ask these cases also to cross subsidise the administration of the majority of cases which contain no funds.”. The argument of why it is fair to ask those cases to cross-subsidise cases which contain no funds (which by implication the AiB is trustee of) is not provided. It is difficult therefore to evaluate whether this statement is correct or not.
The principle of whether cross-subsidy is appropriate or not needs considered separately from the basis of the audit fee calculation.

If cross-subsidy is acceptable then consideration must be given to the work of the AiB as a whole. The consideration of fees in sequestration and trust deeds must be considered alongside fees in DAS. While we welcome the indication in paragraph 24 that there will be a consultation on DAS fees it is unfortunate that the two consultations have not been carried out at the same time to allow a wholistic view of the debt relief system to be taken.

The consultation indicates that DAS is a cost burden for the AiB. The implication therefore is that the fees associated with asset based sequestrations and trust deeds must therefore be subsidising DAS. As DAS is an alternative to sequestration or a trust deed where debt can be repaid over an extended period there is no logical reason for this cross-subsidy.

The consultation suggests that it is acceptable to charge a significantly higher fee than is justified by the work on the basis of cross-subsidy. The consultation also indicates that private trustees will only take on cases with assets. While that is likely to be the case in most circumstances, the consultation fails to acknowledge that in many instances a private trustee will not make a full recovery of the time and costs incurred on a case. There is no ability for a private trustee to cross-subsidise those cases with additional fee recoveries from cases in which there is a great abundance of assets.

While we believe that an element of cross subsidy is acceptable, this must be moderated with ensuring that there is not an unfair burden passed to those providing the subsidy. There must be clear justification and rationale for any cross subsidy including an assessment of the fairness and impact on those affected by the subsidy.

We believe that the audit fee charged on trustee remuneration must be fundamentally reviewed. There are numerous examples of the fee being entirely disproportionate to the work carried out by the AiB and indeed to the other costs associated with administering the sequestration. Some examples are provided below:

Case A –

The debtor owned a small number of properties which were over secured to the bank. Due to the nature of the case, a lot of outlays were incurred and the insurance cover over all the properties totalled approximately £47,000. The Trustee’s fee totalled just under £11,000 while audit fee was £14,163.

Case B –

The debtor owned a small number of properties which were over secured to the bank. Many of the properties were rundown, and works were required to be carried out as an insurance requirement. Due to the nature of the case, a lot of outlays were incurred at the outset of the case and were paid by the firm. The audit fee was £5,949. No fee was paid to the Trustee.

Case C –

The debtor jointly owned a property with his wife which had a high level of equity. The debtor was a very difficult individual to deal with and attempted to impede the sequestration at every stage. The Trustee required to engage legal agents to assist with the raising of an Action for Division and Sale which was challenged by the debtor. The debtor instructed various firms of solicitors to act on his behalf during the period of the sequestration. The time costs on this case were accordingly very high and the Trustee required to restrict his fee to just over £13,000 while an audit fee of £20,924 was payable.
Case D –

Outlays totalling £38,747 were incurred, mostly a single invoice from legal agents of £29,255 for Court of Session action. An audit fee of £5,119 was payable for reviewing that single invoice, what had already been taxed by the Court (for which a fee was also incurred).

A tenant of fees must be that they are fair and reasonable. If the above examples were reflective of fees charges in a private sector scenario and environment there would rightly be a public outcry. This situation is equally untenable in the public sector.

The current fee structure also introduces an anomaly between the fee structure for auditing the remuneration and outlays of a trustee in a sequestration and that of a trustee under a trust deed. The fee in sequestration is based on 17.5% while the fee in a trust deed is based on 5%.

As set out above, disproportionate fee charges are often because of expenses of sequestration which are disproportionate in value to the level of work required to be carried out as part of the audit. The definition of expenses of realisation is unduly restrictive by referring to 'any outlays incurred by the trustee in realising the debtor's estate which in the course of normal business practice are deducted from the price payable to the trustee.' Expenses of realisation often require to be paid by the trustee rather than being deducted from the price payable to the trustee. This definition no longer reflects modern working practices.

We would suggest that if the audit fee is to be retained then there requires to be some alignment of fees charged in sequestration and trust deeds. To provide a more balanced approach the fee for determining remuneration in both processed should be set at 17.5% and a secondary scale rate of 5% be applied to outlays determined. This would be more reflective of the level of work involved in determining outlays to be approved.

Interest on overdue debts due to AiB

We are surprised by the consultation proposal to drop proposals to charge interest on late payment of debts due to the AiB. Although this is unlikely to generate significant income, the objections raised when the previous draft regulations were laid in Parliament were around the interest rate specified rather than the principle of interest being applied.

In principle, we would have no objection to provisions being included for interest on overdue debt payable to the AiB. We do not consider in principle that a public sector creditor should be treated significantly different from a private sector creditor in relation to overdue debts.

If such a proposal were to be re-introduced, then the rate of interest should be set at a more realistic and commercially sensitive level. We would also suggest that it be set against a fluctuating base rate (for example 2% above Bank of England Base Rate).

Funding the AiB

Funding the AiB requires a clear policy to be set out and with greater transparency. This must set out the respective roles of Scottish Government, debtors and creditors who are the stakeholders who ultimately bear the costs.

Once the policy is set then the funding requirements must be considered against a longer-term cycle to take account of fluctuations in bankruptcy numbers over several years. Surpluses generated should be available to mitigate against deficits in other years.

We would also suggest that opportunities may exist for more radical changes to funding to be made. A significant proportion of debt issues arise due to credit being provided which is unaffordable. While steps have been taken to address this ultimately creditors take a decision on whether a debt is capable of repayment. In most of personal insolvencies, the associated debt is mainly consumer debt. It is perhaps arguable that those providing consumer debt should bear more of the cost associated with personal bankruptcy through the creation of a Scottish Consumer Credit Levy.
The Independent Review of the Funding of Debt Advice in England, Wales, Scotland and Northern Ireland carried out by Peter Wyman considers in Chapter 3 how debt advice should be funded and by whom. While clearly the report relates to the funding of debt advice, many parallels can be drawn against the funding of debt relief.

It may be helpful for a more detailed and independent review to be undertaken on the future funding of the AiB. This would provide greater evidence and transparency around future funding sources and would allow consideration of more radical or innovative funding models to be considered.

Consultation question responses

We have set out our response to the consultation questions in Appendix 1.

12 March 2018

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CONSULTATION QUESTIONS

1. Do you agree that upfront debtor application fees should not be increased at this point?
   Yes ☐ No ☒ Don’t know ☒

   Please explain your answer

   There is insufficient evidence available on the actual impact of fees on access to bankruptcy. While anecdotal evidence suggests that there are some debtors who already struggle with the debtor application fee at the current level some further research would be beneficial to inform the debate.

2. Do you think that the principle of full cost recovery is appropriate in the bankruptcy system?
   Yes ☐ No ☒ Don’t know ☒

   See detailed response.

3. Do you agree that it is right to seek to recover the costs across the system as whole, so that there is a degree of cross subsidy between MAP, full administration bankruptcy and PTDs?
   Yes ☐ No ☒ Don’t know ☒

   Please explain your answer

   See detailed response.

4. Do you agree it is right to ask those bankruptcy cases administered by private trustees to make a contribution towards the costs of those cases which contain no funds?
   Yes ☐ No ☒ Don’t know ☒

   Please explain your answer

   See detailed response.

5. Do you agree that it is right that, of the predicted £4.2m shortfall in 2018-19, the public purse should meet the bulk of these costs, with fee increases designed to generate an additional £1m a year in the longer term?
   Yes ☐ No ☒ Don’t know ☒

   Please explain your answer

   See detailed response.

6. Do you agree that the proposals set out in paragraph 29 represent a fair way of generating this additional income?
   Yes ☐ No ☒ Don’t know ☒

   If “no”, what alternative approaches would be fairer?

   See detailed response.

7. Do you agree with our assessment that the proposed increase in upfront creditor fees is unlikely to alter creditor behaviour except at the margins?
Yes ☐ No ☒ Don’t know ☐

If no, what impact do you think it would have?

The increase in upfront creditor fees may impact the decisions of smaller commercial creditors more than governmental/local authority creditors. While the fee itself may be relatively small when added to other costs such as solicitor fees it forms part of the decision making process on whether to pursue bankruptcy or otherwise.

8. Are there any other points you would like to raise?

Please see further comments in main response.
**RESPONDENT INFORMATION FORM**

Please note that this form must be returned with your response to ensure that we handle your response appropriately.

### 1. Name/Organisation

**Organisation Name**

ICAS

**Title**

Mr [x]  Ms [ ]  Mrs [ ]  Miss [ ]  Dr [ ]  Please tick as appropriate

**Surname**

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### 3. Sector

Please tick as appropriate

- Advice Sector [ ]
- Creditor [ ]
- Local Authority [ ]
- Solicitors/Advocates [ ]
- Insolvency Practitioners [ ]
- Debtor [ ]
- Sheriff Officer & Messenger at Arms [ ]
- Judiciary [ ]
- Other [x] If other please specify RPB
4. Permissions - I am responding as...

(a) Do you agree to your response being made available to the public (in Scottish Government library and/or on the Scottish Government website)?

Please tick as appropriate

Yes ☐
No ☐

(b) Where confidentiality is not requested, we will make your responses available to the public on the following basis

Please tick ONE of the following boxes

Yes, make my response, name and address all available ☐
Yes, make my response available, but not my name and address ☐
Yes, make my response and name available, but not my address ☐

(c) The name and address of your organisation will be made available to the public (in the Scottish Government library and/or on the website). Are you content for your response to be made available?

Please tick as appropriate ☐ Yes
☐ No

(d) We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

Please tick as appropriate ☐ Yes
☐ No

Please return your response to AIB_Policy_Development_Enquiries@gov.scot or to: Carol Kirk, AiB, 1 Pennyburn Road, Kilwinning, Ayrshire, KA13 6SA by 12 March 2018.