

Chapter 1

Control and monitoring of District Council expenses and related activities

The Audit Commission (Audit) conducted a review on the control and monitoring of District Council (DC) expenses and related activities.

Tax deduction on 50% of the honorarium for District Council Members

2. The Committee noted from paragraphs 2.14 and 2.15 of the Director of Audit's Report (the Audit Report) that the Commissioner of Inland Revenue had, since 1982, adopted an administrative measure which allowed, without query, a deduction of 50% of the honorarium for a DC Member as tax deductible expenses. Since April 1996, the DC Members' remuneration package had been expanded to include allowance and grant for various office expenses incurred by DC Members for discharging their duties. The current rates of the allowance and grant for reimbursable expenses amounted to almost 50% of the total remuneration package for DC Members. The tax treatment for DC Members' honorarium was different from those for Executive Council (ExCo) Members' and Legislative Council (LegCo) Members' honorariums which were all taxable.

3. The Committee asked whether the Director of Home Affairs had consulted the Commissioner of Inland Revenue on the taxation matters relating to the inclusion of the Office Rental Allowance (ORA) in DC Members' remuneration package in 1996.

4. **Mrs Pamela TAN KAM Mi-wah, Director of Home affairs**, responded that:

- the Home Affairs Department (HAD) had consulted the Commissioner of Inland Revenue in 1995 on whether the ORA was taxable and the Commissioner had given a negative reply; and
- before expanding the scope of the ORA to allow the employment of DC Members' assistants in 2000, the HAD had also consulted the Commissioner in 1999 and the Commissioner had responded that the ORA after the expansion was not taxable.

5. **Mrs Alice LAU MAK Yee-ming, Commissioner of Inland Revenue**, pointed out that the HAD had consulted the Inland Revenue Department (IRD) before adjusting DC Members' honorarium and before starting to provide them with accountable allowance.

6. The Committee asked whether the different tax treatments for the honorariums of LegCo Members and DC Members were fair.

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7. The **Commissioner of Inland Revenue** responded that:
- both LegCo Members and DC Members had the right to claim tax deduction on expenses incurred in discharging their official duties. The administrative measure regarding tax deduction on DC Members' honorarium was an arrangement to deal with their expenses of this nature;
 - the IRD did not adopt such measure on its own initiative. Rather, it would only act on individual employer's or organisation's request for such tax treatment. In considering these proposals, the IRD adopted the same criteria, i.e. whether the amount claimed was small, whether it would be too complicated to keep the receipts and whether the characteristics of the trade concerned warranted such tax deduction. For instance, the IRD had agreed to the Judiciary's proposal of adopting an administrative measure which allowed tax deduction on the expenses for dry-cleaning the wigs and robes of judges, on the grounds that the amount of such expenses was small and the attire was required for the work of judges; and
 - the administrative measure for DC Members' honorarium was proposed to the IRD by the HAD. She was not aware that the LegCo had discussed with the IRD whether LegCo Members required such an administrative measure on tax deduction. If LegCo Members had, in addition to those reimbursable under the operating expenses package, incurred expenses which were wholly, exclusively and necessarily on LegCo business, they could apply to the IRD for tax deduction on such expenses.
8. The Committee enquired about the rationale for adopting the above administrative measure for DC Members' honorarium in 1982 and retaining it despite the expansion of DC Members' remuneration package.
9. The **Commissioner of Inland Revenue** explained that:
- in 1982, DC Members' remuneration package was an all-inclusive non-accountable honorarium to meet earnings forgone due to time spent on DC matters and expenses incurred in connection with DC business. The package did not include an accountable allowance for office expenses incurred by DC Members. The honorarium was, for tax purposes, regarded as an income from office held and as such it would attract Salaries Tax under the Inland Revenue Ordinance (IRO). However, expenses wholly, exclusively and necessarily incurred in the production of income chargeable

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to tax could be claimed for tax deduction under the IRO. The claim, however, had to be substantiated to the IRD. At that time the IRD considered that 50% of the honorarium was a small and reasonable amount of money for expenses wholly, exclusively and necessarily incurred in the production of income and was therefore tax deductible. By allowing such deduction, the IRD could also obviate the need for DC Members to substantiate the deduction claim for such an amount and to keep the relevant documentary evidence of expenses. The IRD therefore adopted the administrative measure;

- after 1982, the honorarium had been increased due to inflation and the strengthening of DC Members' role. In 1996, the remuneration package had been expanded to include the ORA which was replaced by the Accountable Allowance (AA) afterwards. The AA was not taxable because it was used for expenses incurred by DC Members in the strengthening of their role and payable on a reimbursable basis on production of certified receipts for such expenses. The IRD noted the substantial increase in the rate of the AA from \$10,000 to \$17,000 since December 2001. As the administrative measure had already been adopted for a number of years by that time, the IRD decided to retain the measure for the time being;
- according to the table on the percentages of non-taxable income in the total income of DC Members and LegCo Members, in **Appendix 6**, the percentages in respect of DC Members and LegCo Members in 1996 were 61% and 65% respectively. The former percentage rose to 68% following the increase of DC Members' honorarium in 2000, while the latter remained unchanged. After adjustments to the remuneration packages of DC Members and LegCo Members in 2001, the percentages stood at 75% and 69% respectively. The latest percentages in 2004 were 75% and 70% respectively. She considered that as the percentages in respect of DC Members and LegCo Members were comparable, the tax deduction on 50% of DC Members' honorarium, which was used in computing their non-taxable income, was not unreasonable; and
- nevertheless, as the measure had been in force for a number of years, the IRD agreed to Audit's observation that there was a need to review the justifications for continuing the measure. The IRD had discussed with the HAD and come to a preliminary view that the administrative measure should be removed. As a large portion of the current (2004-05) year of assessment had passed and the administrative measure was still in force at present, DC Members might not have kept the receipts for the expenses which would be required for claiming tax deduction. As such, the IRD considered it reasonable for the removal to be implemented for the 2005-06 final and subsequent years of

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assessment. By then DC Members, like other taxpayers, would have to apply for tax deduction on any amount of expenses incurred and keep documentary evidence of such expenses.

10. The Committee asked about the percentage of DC Members who claimed tax deduction on 50% of their honorarium.

11. The **Director of Home Affairs** replied that, in the past four years, about 65% of DC Members claimed tax deduction on 50% of their honorarium and the remaining 35% claimed more than that. Of this 35%, some successfully claimed tax deduction on 100% of their honorarium while the deduction for the others was slightly higher than 50% of their honorarium.

12. The Committee further asked whether DC Members had to submit supporting documentary evidence in making claims for tax deduction on their honorarium.

13. In response, the **Commissioner of Inland Revenue** informed the Committee that:

- DC Members were required to return to the HAD duly completed forms regarding whether or not they would provide a monthly breakdown of expenses for claiming tax deduction;
- for those claiming tax deduction on 50% of their honorarium, they could opt not to provide such breakdown. As the arrangement for tax deduction on 50% of DC Members' honorarium was operated under an honour system, the DC Members concerned did not need to keep or submit supporting documentary evidence; and
- for those claiming tax deduction on more than 50% of their honorarium, they should opt to provide a monthly breakdown of expenses and keep the documentary evidence for verification by the IRD if necessary.

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14. In view of the Commissioner of Inland Revenue's reply that the IRD and the HAD planned to remove the administrative measure starting from the 2005-06 year of assessment, the Committee asked:

- whether the removal of the administrative measure would affect DC Members' services to local residents; and
- whether the Administration had consulted DC Members on the above plan and, if not, whether it would do so.

15. The **Director of Home Affairs** clarified that the plan only gave a direction on the matter. The detailed arrangements for implementing the plan had yet to be worked out. The HAD would proactively communicate with DC Members concerning the impact of the plan on their services to the public, with a view to making reasonable arrangements for the continuation of their services to the local community.

16. The **Commissioner of Inland Revenue** added that the IRD respected the views of LegCo Members and would take into account the Public Accounts Committee's views in its Report before deciding on the plan.

17. In response to the Committee's enquiry about the work plan for implementing the removal, the **Commissioner of Inland Revenue**, in her letter dated 28 December 2004 in *Appendix 7*, informed the Committee that:

- the IRD had contacted the HAD regarding whether there would be any change to the remuneration package of DC Chairmen and Members as well as the control and monitoring measures to be exercised over the reimbursable and non-reimbursable expenses; and
- subject to the HAD's response and the Committee's comments, the IRD would proceed to implement the removal. In any event, the IRD would, through the HAD, advise the DC Chairmen and Members to keep documentary evidence of expenses incurred from 1 April 2005 in support of their tax deduction claims for the 2005-06 final and subsequent years of assessment.

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18. Regarding the IRD's comparison of the non-taxable incomes of DC Members and LegCo Members, the Committee pointed out that the two incomes were very different because, unlike DC Members, LegCo Members could not claim tax deduction on 50% of their honorarium. In fact, LegCo Members' honorarium was all taxable. If 50% of DC Members' honorarium was regarded by the Administration as tax-deductible expenses incurred on DC business, the Administration might consider converting that amount into DC Members' Operating Expenses Allowance (OEA) which was non-taxable. As such, DC Members' honorarium, similar to those of ExCo Members and LegCo Members, would all be taxable.

19. The **Commissioner of Inland Revenue** responded that:

- the above conversion proposal could be an option for consideration by the Administration in its review of the matter. However, if the review concluded that DC Members' honorarium should be kept at the present level, the more reasonable way to deal with the matter was to remove the administrative measure regarding tax deduction on the honorarium; and
- the Administration would closely communicate with DC Members before implementing the removal arrangements. After the removal, DC Members, similar to LegCo Members, could claim tax deduction on the expenses which were wholly, exclusively and necessarily incurred on DC business and which exceeded the amount of the OEA.

Allowance and grant for District Council Members

20. As revealed in paragraph 3.7 of the Audit Report, Audit found 354 cases of non-compliance with the HAD Guidelines on the reimbursement of the OEA and the Information Technology and Other Support Grant (ITOSG) to DC Members during its random sample check on the reimbursement records of the OEA and the ITOSG in respect of DC Members in nine selected District Offices (DOs) for the period January 2002 to March 2004. As these records only concerned some one-third of DC Members in these nine DOs and there were altogether 18 DCs in Hong Kong, the number of non-compliance cases in respect of all DC Members in the territory might probably be much larger than 354. The Committee asked whether the HAD would take immediate action to ensure full compliance with its guidelines.

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21. In response, the **Director of Home Affairs** informed the Committee that:
- the HAD accepted Audit's recommendation that improvements should be made regarding the processing of claims for reimbursement of the OEA. The HAD had started to make such improvements and would review the existing guidelines to provide clearer guidance to its staff at district level;
 - the HAD had asked its staff at district level to strictly follow the HAD Guidelines and exercise meticulous care in processing the claims. The co-operation of DC Members was also necessary, e.g. early submission by DC Members of receipts which were missing in their claims; and
 - some of the 354 cases of non-compliance arose from Audit's interpretation of what constituted non-compliance, which was different from that of the HAD. For instance, name cards containing photographs were, in Audit's view, publicity items containing information other than those allowed in the HAD Guidelines. However, such name cards were regarded by the HAD as printed items and thus photographs were allowed. These different interpretations gave rise to such a large number of cases of non-compliance.
22. The Committee asked about the details of the follow-up actions taken on the 354 cases of non-compliance.
23. In her letter of 31 December 2004 in *Appendix 8*, the **Director of Home Affairs** informed the Committee that the HAD had examined the 354 cases. The HAD would request the DC Members concerned to provide supplementary information in support of their claims and would recover the overpayment of allowance and grant, etc, as soon as possible. It aimed to complete all follow-up actions by March 2005. Details of the follow-up/remedial actions were also provided in the letter.
24. According to paragraphs 3.18 and 3.19 of the Audit Report, the Director of Home Affairs generally agreed with Audit's recommendations regarding non-compliance with and revision of the HAD Guidelines. The Committee asked about the progress in implementing these recommendations.

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25. In her letter of 31 December 2004, the **Director of Home Affairs** pointed out that the HAD:

- had appealed to all DC Members in early December 2004 for full compliance with the HAD Guidelines in claiming reimbursement of the OEA and the ITOSG. It had also held a special briefing with all DC Chairmen and Vice-Chairmen to explain to them the major areas of non-compliance and the imminent introduction of additional control measures to step up the monitoring system;
- had reminded all staff at the district level to process the reimbursement of the OEA and the ITOSG with meticulous care and ensure strict adherence to the HAD Guidelines; and
- was reviewing the HAD Guidelines based on Audit's recommendations and would consult DC Members in January 2005 to seek their comments on the proposed revision.

Use of District Council funds for the Minor Environmental Improvement projects

26. The Committee noted that, in its random sample check of the Minor Environmental Improvement (MEI) projects in nine selected DOs, Audit had found cases of non-compliance with the District Council Funds Guidelines (DCF Guidelines) on the use of DC funds. The MEI projects for grass-cutting jobs were outside the HAD's responsibilities. In addition, some MEI projects for grass-cutting jobs were not cost-effective.

27. The Committee further noted that Audit had recommended that the Director of Home Affairs should, in implementing the MEI projects, ensure that the DOs comply with the requirements and observe the conditions laid down in the relevant circulars and guidelines; evaluate the cost-effectiveness of the projects; and ensure that the Government was protected against claims for accidents arising from the projects. The Committee asked about the progress in implementing Audit's recommendations.

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28. In her letter of 31 December 2004, the **Director of Home Affairs** informed the Committee that the HAD:

- had requested/reminded all DOs to:
 - (a) draw up/update the list of MEI projects for which they had maintenance responsibility; and
 - (b) comply with the DCF Guidelines and government circulars in implementing MEI projects;
- had awarded term contracts for, amongst others, grass cutting in three districts in the New Territories. It planned to expand the term contract system to cover the remaining districts in April 2005; and
- was reviewing the following arrangements and would revise the relevant guidelines where necessary:
 - (a) the need to conduct annual checks for projects requiring maintenance to a high standard; and
 - (b) the granting of cash assistance to rural committees to undertake grass-cutting jobs.

Submission of annual district plans

29. According to paragraphs 5.14 and 5.15 of the Audit Report, the Director of Home Affairs generally agreed with Audit's recommendations regarding monitoring of the submission of the annual district plans (ADPs) by the core departments. The Committee asked about the progress in implementing Audit's recommendations.

30. In her letter of 31 December 2004, the **Director of Home Affairs** informed the Committee that the HAD had drawn up a set of standard procedures for monitoring the submission of the ADPs by the core departments. All DOs had been requested to adhere to the standard procedures with effect from 1 January 2005.

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District Council Homepages

31. The Committee noted that Audit had reviewed the Homepages of all the 18 DCs and found cases of non-compliance with the Guidelines on Dissemination of Information through Government Homepages (Government Homepage Guidelines) and improper use of DC funds for developing additional homepages.

32. The Committee further noted that Audit had recommended that the Director of Home Affairs should encourage the DC Secretariats to follow the Government Homepage Guidelines and improve the contents of DC Homepages, and review the use of DC funds for the development and maintenance of separate homepages for the DCs. The Committee asked about the progress of implementing Audit's recommendations.

33. In her letter of 31 December 2004, the **Director of Home Affairs** informed the Committee that the HAD:

- had advised the DCs to follow the Government Homepage Guidelines;
- would assist DCs in drawing up short-term and long-term improvement plans for their respective DC Homepages, having regard to the current level of compliance with the relevant Audit's recommendations, individual district needs and characteristics; and
- had reviewed the use of DC funds for developing additional DC Homepages and revised the existing arrangement so that DC funds could be used for one-off development and/or annual enhancement/maintenance of these homepages on a project-by-project basis.

34. **Conclusions and recommendations** The Committee:

Tax deduction on 50% of the honorarium for District Council Members

- expresses serious concern that the Commissioner of Inland Revenue continued to adopt the administrative measure which allows, without query, a deduction of 50% of the honorarium for a District Council (DC) Member as tax deductible expenses despite the fact that, since April 1996, the DC Members' remuneration package has been expanded to include allowance and grant for various office expenses incurred by DC Members for discharging their duties;

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- expresses concern that the tax treatments for the honorarium of DC Members and those of Executive Council (ExCo) Members and Legislative Council (LegCo) Members are not the same. The honorariums of ExCo Members and LegCo Members are all taxable whereas a tax deduction on 50% of a DC Member's honorarium is allowed;
- notes that the Commissioner of Inland Revenue plans to remove the above administrative measure for the 2005-06 final and subsequent years of assessment;
- recommends that the Director of Home Affairs should consider revising the existing remuneration package of DC Members by converting 50% of a DC Member's honorarium to the Operating Expenses Allowance (OEA) which is non-taxable, so that DC Members' honorarium, similar to those of ExCo Members and LegCo Members, is all taxable;

Allowance and grant for District Council Members

- expresses alarm and strong resentment that:
 - (a) 354 cases of non-compliance with the Home Affairs Department (HAD) Guidelines on the reimbursement of the OEA and the Information Technology and Other Support Grant (ITOSG) to DC Members were found by the Audit Commission during its random sample check on the reimbursement records of the OEA and the ITOSG in respect of only about one-third of the DC Members of nine selected District Offices (DOs); and
 - (b) despite complaints from time to time against DC Members for misusing the OEA subsidised ward offices for non-DC activities, the HAD Guidelines still do not provide adequate guidance for the DOs to deal with issues relating to such misuse;
- expresses serious concern that the supporting documents to substantiate the OEA claims for the employment of assistants by DC Members are inadequate;
- expresses concern that:
 - (a) the HAD Guidelines do not specify the detailed requirements of a site visit to DC Members' ward offices; and

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- (b) there is no procedure for handling the return of capitalised items partly paid for by DC Members;
- notes that the HAD:
 - (a) has examined the 354 cases of non-compliance and will request the DC Members concerned to provide supplementary information in support of their claims and will recover the overpayment of allowance and grant, etc, as soon as possible. It aims to complete all follow-up actions by March 2005;
 - (b) has appealed to all DC Members in early December 2004 for full compliance with the HAD Guidelines in claiming reimbursement of the OEA and the ITOSG. It has also held a special briefing with all DC Chairmen and Vice-Chairmen to explain to them the major areas of non-compliance and the imminent introduction of additional control measures to step up the monitoring system;
 - (c) has reminded all staff at the district level to process the reimbursement of the OEA and the ITOSG with meticulous care and ensure strict adherence to the HAD Guidelines; and
 - (d) is reviewing its Guidelines based on audit recommendations in paragraph 3.18(b) of the Director of Audit's Report and will hold consultation with DC Members in January 2005 to seek their comments on proposed revision of the Guidelines;

Use of District Council funds for the Minor Environmental Improvement projects

- expresses grave concern and finds it unacceptable that:
 - (a) contrary to the District Council Funds Guidelines (DCF Guidelines), seven out of nine selected DOs did not maintain an up-to-date list of all the Minor Environmental Improvement (MEI) projects for which they had maintenance responsibility;
 - (b) approvals for some MEI projects given by the approving officers were not in line with the approving authority stated in the DCF Guidelines;
 - (c) extra works not covered by the DC's original approval were included in an MEI project;

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- (d) payments for some MEI projects were not in accordance with the relevant circulars or guidelines;
 - (e) some MEI projects for grass-cutting jobs were outside the ambit of the HAD's responsibilities;
 - (f) the arrangement of some MEI projects for grass-cutting jobs under separate contracts was not cost-effective; and
 - (g) some MEI projects for grass-cutting jobs undertaken by a rural committee were not cost-effective and the Government is exposed to claims for accidents arising from the projects;
- notes that the HAD:
- (a) has requested/reminded all DOs to:
 - (i) draw up/update the list of MEI projects for which they have maintenance responsibility; and
 - (ii) comply with the DCF Guidelines and government circulars in implementing MEI projects;
 - (b) has awarded term contracts for, amongst others, grass cutting in three districts in the New Territories. It plans to expand the term contract system to cover the remaining districts in April 2005; and
 - (c) is reviewing the following arrangements and will revise the relevant guidelines where necessary:
 - (i) the need to conduct annual checks for projects requiring maintenance to a high standard; and
 - (ii) the granting of cash assistance to rural committees to undertake grass-cutting jobs;

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Submission of annual district plans

- expresses concern that:
 - (a) the overall average submission rate of 55% of the annual district plans (ADPs) by the core departments, for the period from January 2002 to June 2004, was not satisfactory;
 - (b) the non-submission of the ADPs by the core departments might affect the effectiveness of the DCs in reflecting the community views on their work plans; and
 - (c) the HAD had not issued guidelines on the standard procedures to be followed by all the DOs for monitoring and following up the submission of the ADPs by the core departments;
- notes that the HAD has drawn up a set of standard procedures for monitoring the submission of ADPs by core departments. All DOs have been requested to adhere to the standard procedures with effect from 1 January 2005;

District Council Homepages

- expresses concern that there were cases of non-compliance with the Guidelines on Dissemination of Information through Government Homepages (Government Homepage Guidelines) in the set-up and maintenance of the 18 DC Homepages;
- expresses dismay that two DCs used DC funds to set up their own separate homepages showing their DC activities, which were not appropriate under the guidelines on the use of DC funds;
- notes that the HAD:
 - (a) has advised the DCs to follow the Government Homepage Guidelines;
 - (b) would assist DCs in drawing up short-term and long-term improvement plans for their respective DC Homepages, having regard to the current level of compliance with the relevant audit recommendations, individual district needs and characteristics; and

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- (c) has reviewed the use of DC funds for developing additional DC Homepages and revised the existing arrangement so that DC funds can be used for one-off development and/or annual enhancement/maintenance of these homepages on a project-by-project basis; and

Follow-up actions

- wishes to be kept informed of:
 - (a) the progress of implementing the removal of the administrative measure regarding tax deduction;
 - (b) the decision made by the Director of Home affairs on the Committee's recommendation that 50% of a DC Member's honorarium be converted to the OEA and any progress made;
 - (c) the progress and results of the follow-up actions taken on the 354 cases of non-compliance;
 - (d) the progress of reviewing the HAD's Guidelines on the reimbursement of the OEA and the ITOSG;
 - (e) the progress of reviewing the need to conduct annual checks for the MEI projects requiring maintenance to a high standard and the granting of cash assistance to rural committees to undertake grass-cutting jobs; and
 - (f) the progress of assisting DCs in drawing up short-term and long-term improvement plans for their respective DC Homepages.