

**立法會**  
**Legislative Council**

LC Paper No. CB(1)1311/04-05  
(These minutes have been seen  
by the Administration)

Ref : CB1/PL/FA/1

**Panel on Financial Affairs**

**Minutes of meeting**  
**held on Monday, 7 March 2005 at 9:30 am**  
**in the Chamber of the Legislative Council Building**

- Members present** : Hon Bernard CHAN, JP (Chairman)  
Hon Ronny TONG Ka-wah, SC (Deputy Chairman)  
Hon James TIEN Pei-chun, GBS, JP  
Hon Albert HO Chun-yan  
Hon LEE Cheuk-yan  
Dr Hon David LI Kwok-po, GBS, JP  
Hon James TO Kun-sun  
Hon SIN Chung-kai, JP  
Hon Emily LAU Wai-hing, JP  
Hon Abraham SHEK Lai-him, JP  
Hon Jeffrey LAM Kin-fung, SBS, JP  
Hon Andrew LEUNG Kwan-yuen, SBS, JP  
Hon WONG Ting-kwong, BBS  
Hon CHIM Pui-chung  
Hon Albert Jinghan CHENG  
Hon TAM Heung-man
- Member absent** : Hon CHAN Kam-lam, JP

**Public officers attending** : Agenda Item IV

Mr Kevin HO, JP  
Permanent Secretary for Financial Services and the  
Treasury (Financial Services)

Miss Alice CHEUNG  
Principal Assistant Secretary for Financial Services and  
the Treasury (Financial Services)

Agenda Item V

Mr Frederick MA, JP  
Secretary for Financial Services and the Treasury

Mr Kevin HO, JP  
Permanent Secretary for Financial Services and the  
Treasury (Financial Services)

Ms Emma LAU, JP  
Deputy Secretary for Financial Services and the Treasury  
(Financial Services)

Mr Gordon JONES, JP  
Registrar of Companies

Agenda Item VI

Mr Frederick MA, JP  
Secretary for Financial Services and the Treasury

Mr Alan LAI, JP  
Permanent Secretary for Financial Services and the  
Treasury (Treasury)

Mr Martin GLASS, JP  
Deputy Secretary for Financial Services and the Treasury  
(Treasury)

- Attendance by invitation** : Agenda Item IV  
Securities and Futures Commission  
Mr Peter AU-YANG  
Executive Director and Chief Operating Officer  
Mr Leo LEE  
Director, Finance and Administration  
Mrs Cindy FUNG  
Director, Human Resources, Training and Development
- Clerk in attendance** : Miss Salumi CHAN  
Chief Council Secretary (1)5
- Staff in attendance** : Ms Pauline NG  
Assistant Secretary General 1  
Ms Connie SZETO  
Senior Council Secretary (1)4  
Ms May LEUNG  
Legislative Assistant
- Agenda Item VI  
Mr Watson CHAN  
Head (Research and Library Services Division)  
Mr Jackie WU  
Research Officer 1
-

**I. Confirmation of minutes of meetings**

(LC Paper No. CB(1)1017/04-05 — Minutes of special meeting on 17 December 2004

LC Paper No. CB(1)1019/04-05 — Minutes of special meeting on 19 January 2005)

The minutes of the two special meetings held on 17 December 2004 and 19 January 2005 respectively were confirmed.

**II. Information paper issued since the last meeting**

2. Members noted that an information paper on “Mandatory Provident Fund Schemes Statistical Digest — December 2004 (LC Paper No. CB(1)1010/04-05)” had been issued since the last regular meeting held on 17 February 2005.

**III. Date of next meeting and items for discussion**

(LC Paper No. CB(1)1020/04-05(01) — List of outstanding items for discussion

LC Paper No. CB(1)1020/04-05(02) — List of follow-up actions)

3. Members agreed that the following items be discussed at the next regular meeting of the Panel to be held on Monday, 4 April 2005, at 10:45 am:

- (a) Briefing on the legislative proposal to provide exemption for offshore funds; and
- (b) Briefing on the Securities and Futures (Amendment) (No. 2) Bill 2005 - proposals to give statutory backing to major listing requirements.

4. On paragraph 3(a) above, members noted that the Administration would brief the Panel on the proposed amendments to the Inland Revenue Ordinance (Cap. 112) for implementing the proposal to exempt offshore funds from profits tax. The Administration planned to introduce the relevant bill into the Legislative Council (LegCo) in June 2005. As regards paragraph 3(b), members noted that the Administration would brief the Panel on the proposed amendments to the Securities and Futures Ordinance (SFO) (Cap. 571), including the proposal to give statutory backing to major listing requirements, and other miscellaneous amendments. The Administration planned to introduce the relevant bill into LegCo in June 2005.

#### IV. The Securities and Futures Commission Budget for the Financial Year 2005-06

(LC Paper No. CB(1)1020/04-05(03) — Paper provided by the Administration (with Securities and Futures Commission's proposed estimates of income & expenditure for the financial year 2005-06))

##### Briefing on the Securities and Futures Commission Budget for 2005-06

5. At the Chairman' invitation, Mr Peter AU-YANG, Executive Director and Chief Operating Officer of the Securities and Futures Commission (SFC) compared SFC's approved budget for 2004-05 with the revised estimates and presented the main features of the budget for 2005-06. He highlighted the following points:

- (a) 2004-05 was a very good year in terms of market activities. The average daily turnover in the Stock Exchange of Hong Kong (SEHK) in the first seven months of the year to 31 October 2004 was \$14.3 billion (30% higher than that assumed in the approved estimates), while the trading in the Hong Kong Futures Exchange was 29% more active than expected. Higher number of licensing applications and more corporate activities had brought in more fees and charges income. The revised estimated revenue for 2004-05 was \$554.77 million, representing an increase of 24% from the approved estimated revenue. On the expenditure side, the revised expenditure was \$450.44 million. Major changes included increases in personnel expenses by 9%, premises expenses by 9%, training and development expenses by 46%, and expenses on external relations by 37%. Taking the revised estimated revenue and revised estimated expenditure together, the estimated surplus of \$3.93 million in the approved estimates for 2004-05 had been revised to \$77.83 million. However, the revised estimates prepared in November 2004 were based on a projection of an average daily turnover of \$14.3 billion for the five months to 31 March 2005. The actual performance of the market had been better than the original projection. SFC's accumulated surplus for 2004-05 stood at \$155 million as at 28 February 2005.
- (b) As regards the budget for 2005-06, SFC proposed a surplus budget of \$4.36 million with a reduction of 7.5% in estimated revenue and an increase of about 7% in operating expenditure as compared with the revised estimates of 2004-05. Securities levy income was expected to decrease as the average daily turnover of SEHK for 2005-06 was projected to be \$13 billion versus \$14.3 billion assumed in the 2004-05 revised estimates. The same level of levy income from trading of futures/options contracts was assumed. Income from fees and charges

was expected to decrease as a result of consolidation of businesses by existing licensees. In the 2005-06 budget, there would be increases in premises expenses, personnel expenses, training and development expenses, and external relations expenses together with a one-off start up contribution of \$2.5 million and recurrent annual contribution of \$2.5 million to provide for the funding of the proposed Financial Reporting Council.

- (c) With the projected budget surplus and a reasonable size of reserves, SFC had for the thirteenth consecutive year not requested for any appropriation from LegCo. It was estimated that the annual government grant foregone by SFC would amount to about \$84 million, and that the total annual grant foregone since 1993-94 had amounted to \$1.1 billion. SFC estimated that its reserves would increase from \$768.86 million (as at 31 March 2005) to \$773.22 million (as at 31 March 2006). The estimated reserves as at 31 March 2006 would be equivalent to about 18 months of the proposed annual operating expenses for 2005-06. SFC would continue to tightly control its expenditure. SFC had been able to keep its actual expenditure within a tight budget in last few years as a result of adoption of stringent cost control measures. During the years between 2000-01 and 2003-04, SFC achieved a total saving of more than \$180 million while coping with enormous workload and continued challenges in regulating the financial markets.
  
- (d) In the budget for 2005-06, the increase in resource requirements was to cope with SFC's new regulatory functions and increasing workload arising from existing duties. In respect of new regulatory functions, SFC would be responsible for administering and enforcing the new statutory listing rules relating to financial reporting and disclosure. In addition, SFC would require resources to strengthen supervision and regulation of sponsors, handling the conduct issues of investment advisers, policy issues arising from the consultation on public offering and disciplinary work from the expanded jurisdiction of the Market Misconduct Tribunal. Regarding existing duties, an analysis of SFC's work for the three financial years from 2001-02 to 2003-04 showed that increased workload was generated by implementation of the dual filing system; enforcement of the SFO; and increase in the number of enforcement cases, new investment products, complaints and enquiries. During the same period, SFC's increase in headcount was only 5%, which was much lower than those of its counterparts in Australia, the United Kingdom (UK), the United States (US) and Singapore. As such, SFC proposed to establish 20 posts (12 in the 2004-05 revised estimates and 8 in 2005-06). The total establishment would become 422 (comprising 414 permanent established posts and 8 temporary established posts) by end of 2005-06.

- (e) SFC would need resources to address the problems of staff recruitment and retention. Due to the recovery of the local economy and improved market conditions, SFC had experienced increasing staff turnover since the beginning of 2004. The overall staff turnover for the past twelve months ended 31 January 2005 was about 12%, while the turnover rate of executive staff and non-executive staff was about 13% and 10% respectively. The turnover of Managers and Assistant Managers was particularly serious, ranging from about 17% to 30%. SFC also faced difficulties in recruiting professional staff such as lawyers and accountants due to competition from professional firms and the financial market for talents. Having regard to the high turnover rates, SFC considered it necessary to award variable pay in 2004-05 to address the problem and hence included a provision of \$26.3 million in the revised estimates for 2004-05 for the purpose. The same provision for variable pay award was made in the budget for 2005-06. The establishment of new permanent posts and the provision of variable pay would bring SFC average staff cost back to the level of 2000-01 before the market downturn. It had to be noted that SFC was able to keep its actual staff costs below the level of 2000-01 during the period from 2001-02 to 2003-04. On the contrary, the staff costs of its counterparts in Australia, UK, US and Singapore had increased by between 14% and 63% during the same period.

6. The Permanent Secretary for Financial Services and the Treasury (Financial Services) (PS/FST(FS)) advised that SFC had adopted a prudent approach in preparing a surplus budget for 2005-06. The Administration was pleased to note that SFC had not requested for appropriation from LegCo. On the expenditure side, the Administration had expressed concern to SFC about the proposed increase in its staff establishment in the light of the general trend of downsizing in public and private sectors. SFC had subsequently reviewed and trimmed down its staffing requirements and came up with the current proposal. The Administration had urged SFC to be vigilant in managing its staff resources and to consider internal redeployment of staff and streamlining of workflow to cope with new responsibilities and increase in demand. As regards the review of SFC levies, PS/FST(FS) advised that under the SFO, SFC levies would be reviewed if SFC had accumulated reserves equivalent to twice its annual operating expenses. As SFC's reserves were below the threshold, the Administration did not have immediate plan to review the levies for the moment. The Administration would keep in view the reserves level of SFC and review the level of levies once the threshold was reached.

Discussion

*Proposal of splitting the Chairman post of SFC*

7. Mr SIN Chung-kai enquired whether the SFC's budget for 2005-06 had taken account of the Administration's proposal of splitting the Chairman post of SFC into a Chairman post and a Chief Executive Officer (CEO) post. Mr Peter AU-YANG said that when SFC prepared the budget for 2005-06 in October/November 2004, the Administration had not made a firm decision on the proposal. As such, no provisions had been made in the budget for implementing the proposal. At the request of Mr SIN, Mr AU-YANG undertook to provide information on the annual expenses incurred by SFC's Chairman's Office in the previous few years for members' reference.

*(Post-meeting note: The information provided by SFC (LC Paper No. CB(1)1189/04-05(02)) was circulated to members on 1 April 2005.)*

8. Mr Ronny TONG enquired about how the expenses for setting up a new CEO Office would be met if the splitting proposal was endorsed by LegCo. Mr Peter AU-YANG advised that the expenditure required for implementing the proposal could be incorporated in SFC's revised estimates for 2005-06 to be prepared in late 2005. Shortfalls in the budget could be absorbed by SFC's reserves.

*Proposed increase in staff establishment of SFC*

9. Mr Jeffrey LAM was pleased to note that there would be substantial increase in SFC's estimated surplus in 2004-05 and that SFC had not requested for Government funding for the financial year 2005-06. However, he was concerned that SFC's proposal of increasing 20 posts would be against the general trend of downsizing in public and private sectors. He enquired about the justifications for the proposal and whether SFC had considered alternative measures.

10. Mr Peter AU-YANG explained that the proposed increase of 20 posts, which was about 5% of SFC's total establishment of 410 posts in the approved budget for 2004-05, would be a minimal increase in staffing requirement to meet the needs of SFC in undertaking new regulatory functions and coping with increasing workload arising from existing duties. The proposal was made after careful consideration of alternative measures including internal redeployment of staff and streamlining of workflow. Owing to the concern expressed by the Administration on the proposed expansion, SFC had subsequently reviewed and trimmed down its staffing requirements three times to come up with the current proposal.

11. Ms Emily LAU welcomed SFC for presenting its annual budget to the Panel for information. Whilst appreciating the need for SFC to attract and retain quality staff by awarding viable pay, Ms LAU expressed concern about the proposed increase in SFC's staff establishment. Noting that the Administration had expressed



concern about the proposed staffing expansion, she sought the Administration's clarification on its stance on the proposal.

12. PS/FST(FS) advised that SFC's original proposal was to increase over 40 posts. The Administration had expressed concern over the proposal in the light of the general trend of downsizing in public and private sectors. SFC had subsequently reviewed and trimmed down its staffing requirements to arrive at the current proposal. While the Administration had urged SFC to be vigilant in managing its staff resources, it noted SFC's view that it was imperative to have the staff increase in order to perform the new regulatory responsibilities and to keep up with market developments. PS/FST(FS) said that the Administration was still examining SFC's budget for 2005-06 and would take into account members' views in approving the budget. Nonetheless, having regard to the need for SFC to cope with its new regulatory functions, there might be little room for SFC to further trim down its staffing proposal. Ms Emily LAU urged the Administration to critically examine the need for SFC to increase the 20 posts.

Admin

*Review of staff salaries and award of variable pay*

13. Miss Mandy TAM and Mr WONG Ting-kwong enquired about the reasons and details of SFC's proposal to adjust staff salaries and award variable pay in 2004-05 and 2005-06.

14. Mr Peter AU-YANG advised that there had been no general pay increase for SFC staff since April 2001 and no variable pay award in 2001-02 and 2002-03. Having regard to the high level of staff turnover in 2004, SFC considered it necessary to address the problems of staff recruitment and retention. While SFC had not proposed a general salary increase across the board for 2005-06 in order to contain fixed costs, it had approved the Remuneration Committee's recommendations to award variable pay to staff and to adjust the fixed pay of some staff to achieve market parity in particular where there were high levels of staff turnover. The Remuneration Committee, which comprised all non-executive directors of SFC, had recommended using about 1.4 months' salary of the wage bill as variable pay to staff for the year 2004-05. The figure was in line with the bonus level of the market in 2004-05. A provision of \$26.3 million had been made in the revised estimates for 2004-05 for the purpose. Mr AU-YANG added that notwithstanding that the same provision for variable pay had been included in the budget for 2005-06, SFC would decide by the end of the financial year 2005-06 whether staff should be awarded variable pay for 2005-06, taking into account SFC's financial position, the staff turnover rate, and the trend of pay review in the market.

15. Pointing out that the Government had reduced civil service pay and that Hong Kong had suffered from deflation in recent years, Mr CHIM Pui-chung enquired whether SFC had plans to review the level of staff salaries.

16. In response, Mr Peter AU-YANG said that SFC conducted annual review on staff salaries to ensure that the level of remuneration of its staff was on par with that in the market. Reviews conducted in recent years had revealed that the median wages for SFC's staff in grades with high turnover rates were lower than those in the private sector, demonstrating a need for SFC to address the problems of staff recruitment and retention.

*SFC's fees and charges*

17. Noting that there had not been any revision in the level of SFC's fees and charges since 1994 and given the substantial increase in SFC's estimated surplus in 2004-05, Mr Jeffrey LAM enquired whether SFC had plans to reduce the level of its fees and charges.

18. In response, Mr Peter AU-YANG advised that market levies and fees and charges generated from services provided by SFC to the market, such as licensing and authorization of investment products, were SFC's two main sources of revenue. While some divisions of SFC, including the Intermediaries and Investment Products Division, adopted the "users pay" principle to recover the costs of services, other divisions, such as the Enforcement Division, did not adopt the principle and were funded by SFC's incomes. In 2004-05, the overall cost recovery rate achieved by those divisions which adopted the "users pay" principle was only 80%. Having regard to the existing cost-recovery rate of services, there would be limited room for SFC to reduce its fees and charges.

19. Mr Jeffrey LAM suggested that SFC should conduct an overall review of its operation to examine the feasibility of reducing its fees and charges. Ms Emily LAU supported the suggestion. She further enquired whether the Administration would consider reducing SFC levies.

20. PS/FST(FS) said that it was the Administration's stance that SFC should consider reducing its fees and charges should there be room for doing so. Mr Peter AU-YANG re-iterated the importance of adhering to the "users pay" principle for recovering the costs of services from fees and charges. He also pointed out that it would be inappropriate to reduce SFC's fees and charges because of the substantial growth in income from market levies in 2004-05, as it would result in investors (who paid the levies) subsidizing market participants (to whom the SFC provides its services).

21. As regards SFC levies, PS/FST(FS) said that as the reserves level of SFC was below the threshold provided in the SFO, the Administration had no immediate plan to review SFC levies at the present stage. The Administration would keep in view the reserves level of SFC and conduct a review together with SFC on the level of levies once the threshold was reached. PS/FST(FS) supplemented that in considering whether SFC levies should be reduced, the Administration and SFC would take into

account the performance of the market, which would have an impact on the revenue and reserves of SFC.

22. On the concern about the levy adjustment mechanism, Mr Peter AU-YANG advised that the mechanism was to ensure that SFC would have sufficient reserves to meet its expenses even during periods of low market turnover. Notwithstanding the substantial increase in income from market levies in 2003-04 and 2004-05 resulting from robust market activities, the surplus from the two financial years were required to replenish SFC's reserves, which had been drawn down for meeting operating deficits due to severe reduction in income from market levies arising from unfavourable market performance in 2001-02 and 2002-03.

SFC 23. Mr CHIM Pui-chung pointed out that licensed corporations were required to pay fee for each type of regulated activities they carried out under SFC's new licensing regime as opposed to paying a single fee under the old licensing regime. He urged that SFC should consider reviewing the new licensing regime to identify whether there was any room for reducing its licensing fees. In this connection, Mr SIN Chung-kai indicated support for SFC to adopt the "users pay" principle in setting the licensing fees.

24. Mr Peter AU-YANG said that the new licensing regime would streamline the procedures for application for SFC licences. Under the new licensing regime, licensees were only required to pay for the types of regulated activities in which they were engaged. It was not the intention of SFC to raise revenue by introducing the new regime.

*Expenses on office premises*

25. Ms Emily LAU noted from paragraph 33 of SFC's proposed estimates of income and expenditure for 2005-06 (Annex to the paper) that SFC had set up a back-up office in Kwun Tong in October 2004. She enquired about the reasons for establishing the office.

26. Mr Peter AU-YANG explained that in the past, SFC had made arrangement with the Hong Kong Monetary Authority and the Hong Kong Exchanges and Clearing Company Limited to borrow their accommodation for meeting emergency use. In the wake of the 911-incident and the outbreak of the Severe Acute Respiratory Syndrome (SARS), SFC had reviewed its contingency measures for handling emergencies. The review revealed the need for SFC to set up its own back-up office as a first port of call or command centre in case of emergency. Moreover, with a view to ensuring the normal operation of SFC in the event of emergency, SFC would deploy staff members to work in the back-up office. Mr AU-YANG stressed that SFC was mindful of the need to ensure the cost-effectiveness of the operation of the back-up office. The new office was only about 2 300 square feet (sq. ft.) in size at a rental of \$4.89 per sq. ft. Responding to further enquiries by members, Mr

AU-YANG advised that during the outbreak of SARS in 2003, due to the lack of a back-up office, SFC had to arrange some staff members to work at home.

27. The Chairman noted that SFC had leased additional accommodation at Chater House since July 2004. He enquired about the reasons involved and whether SFC had considered leasing offices in districts other than Central so as to save costs.

28. Mr Peter AU-YANG explained that the additional accommodation at 5<sup>th</sup> floor of Chater House was provided to cater for staff expansion. While SFC had considered leasing offices in other districts, it finally decided to lease more office spaces in Chater House because of three reasons. Firstly, Chater House was close to the Exchanges and offices of other financial services regulators. Secondly, it was not efficient workwise to have offices in two locations. Thirdly, when SFC signed the rental contract for its existing accommodation at Chater House in 2003, it was given a lease option to lease the reserved office space (around 11 900 sq. ft.) at Chater House. SFC exercised the lease option in July 2004 to lease the reserved office space at an effective rent which compared favourably with the prevailing market rate.

SFC 29. Whilst appreciating the need for SFC to maintain close communication with the Exchanges and other financial services regulators, the Chairman suggested that SFC should consider leasing offices in districts other than Central, which offered lower office rentals.

*Other issues*

30. Given the robust level of SFC's reserves, Miss Mandy TAM enquired whether SFC had plans to devote more resources to enhance its operational structure and performance in the long run. In response, Mr Peter AU-YANG said that resources would be deployed to those divisions for undertaking the new regulatory functions, including administration of statutory listing rules and regulation of sponsors and investment advisers. He assured members that SFC would review its internal structure and work process to cater for the new regulatory functions.

31. The Chairman enquired whether fines imposed on SFC's licensees for non-compliance with the requirements under SFO would be regarded as income of SFC. In reply, Mr Leo LEE, Director of Finance and Administration of SFC advised that the settlement fines were collected by SFC and then transferred to the Treasury as government revenue.

**V. Proposals to enhance the oversight of public interest activities of auditors and establish a Financial Reporting Council**

(LC Paper No. CB(1)1020/04-05(04) — Paper provided by the Administration (with consultation paper on the legislative proposals to establish the Financial Reporting Council)

LC Paper No. CB(1)1020/04-05(05) — Background brief prepared by the Legislative Council Secretariat)

Briefing by the Administration

32. Upon the Chairman's invitation, the Secretary for Financial Services and the Treasury (SFST) gave a brief account of the background of the Administration's proposal to establish the Financial Reporting Council. SFST highlighted the following points:

- (a) In December 2002, the Administration requested the Hong Kong Society of Accountants (HKSA) (subsequently renamed as the Hong Kong Institute of Certified Public Accountants (HKICPA)) to put forward proposals to strengthen the regulatory regime for the accounting profession. In January 2003, HKSA put forward four major reform proposals. Three of the reform proposals relating to opening up HKSA's governance structure were incorporated into the Professional Accountants (Amendment) Bill 2004 sponsored by Dr Hon Eric LI and passed by LegCo in July 2004. The remaining proposal was to set up an independent investigation board (IIB) to investigate irregularities of auditors of listed corporations. Moreover, the Standing Committee on Company Law Reform had recommended in its consultation paper on Phase I of the Corporate Governance Review the establishment of a Financial Reporting Review Panel (FRRP) to check the compliance of financial reporting of listed corporations with relevant legal and accounting requirements.
- (b) In September 2003, the Administration issued a consultation paper to seek public views on the proposals on IIB and FRRP. Most respondents generally supported the proposals. Building on the public support received, the Administration, in consultation with the Hong Kong Exchanges and Clearing Limited (HKEx), HKICPA and SFC, proposed to establish a new statutory body to be named as the Financial Reporting Council (FRC). The FRC would oversee both the independent investigation board (to be named as the Audit Investigation Board (AIB)) and the Financial Reporting Review Committee(s) (FRRC).

- (c) On 28 February 2005, the Administration issued the “Consultation Paper on the Legislative Proposals to Establish the Financial Reporting Council” (Consultation Paper) to consult the relevant stakeholders and the public on the detailed proposals. The proposals contained in the Consultation Paper aimed to underpin a draft bill being formulated by the Administration. The Administration welcomed members’ views on the Consultation Paper. Subject to the outcome of the consultation exercise, the Administration planned to introduce the relevant bill into LegCo within the 2004-05 session.

33. The Deputy Secretary for Financial Services and the Treasury (Financial Service) (DS/FST(FS)) took members through the detailed proposals contained in the Consultation Paper which were summarized as follows:

(a) Composition of the FRC

It was proposed that the FRC would comprise not more than eleven members with the majority being lay persons. i.e. non-accountants. The non-executive Chairman would be appointed by the Chief Executive (CE) from among the lay persons appointed, and supported by the Chief Executive Officer, who would also be a member of the FRC.

(b) Functions of the AIB

The AIB would be responsible for investigating suspected irregularities of auditors of listed corporations in relation to the audit of published accounts or financial statements of such corporations and the preparation of any auditors’ reports for inclusion in prospectuses. Investigations would mainly be carried out by staff of the FRC. The proposed investigatory framework of the AIB was modelled on SFC’s powers of investigation under sections 179 and 183 of the SFO. In short, where it appeared to the AIB that there were circumstances suggesting the occurrence of auditors’ irregularities, the AIB might require the auditor of a listed corporation or other persons (e.g. the corporation itself and its officers and employees) to produce records or documents relating to the affairs of the corporation. It would also be empowered to ask for an explanation on the information. Moreover, if the AIB had reasonable cause to believe that an auditor of a listed corporation had engaged in irregularities, it might require the person under investigation to attend before it to answer any relevant questions and give all reasonable assistance in connection with the investigation. The proposed design would be an enhancement over the relatively limited powers vested in the Investigation Committees of HKICPA under the Professional Accountants Ordinance (PAO) (Cap. 50) in respect of investigation into suspected irregularities of the Institute’s members.

(c) Functions of the FRRC

The FRRC would be responsible for enquiring into suspected non-compliance of the financial reports of listed corporations with relevant accounting requirements under the Companies Ordinance (Cap. 32), the relevant SFC Codes, Listing Rules, and Financial Reporting Standards. It was proposed that a FRRC would be constituted to enquire into a case of questionable financial reports by at least five members drawn from a FRRP. The FRRP would comprise not less than 20 members who would be appointed by the CE in consultation with the FRC. They would be from a wide range of financial reporting, auditing, banking, financial services and commercial expertise. It was proposed that, with reference to the similar set-up in UK, a FRRC would be empowered to require information from relevant persons; request for a voluntary rectification of accounts and financial statements; seek a court order to mandate such a rectification; and consult other professional and regulatory bodies in the course of the enquiries.

(d) Referral and publication of investigation/enquiry reports

The majority views reviewed in the public consultation were that the function of the FRC should remain purely investigatory. It was proposed that upon completion of the investigation/enquiry, the AIB or a FRRC should submit an investigation/enquiry report to the FRC for consideration and deciding on the follow-up actions.

(e) Accountability and independence of the FRC

To enable the FRC to function independently, fairly, properly, efficiently and with due propriety, it was proposed that accountability measures be put in place. These measures included the approval of the FRC's budget by the Secretary for Financial Services and the Treasury; the audit of the FRC's accounts by the Director of Audit; and the laying of the annual report and accounts together with the auditor's report before LegCo. In addition, actions of the FRC might be subject to judicial review by the court, and complaints against actions and staff members of the FRC might be lodged with the Ombudsman. The relevant bill would also contain provisions in respect of the avoidance of conflict of interests to uphold the independence and credibility of the FRC.

(f) Funding arrangement for the FRC

The Administration, HKEx, HKICPA and SFC had agreed to contribute to the funding of the FRC on an equal share basis. The Administration's contribution would be funded by the Companies Registry Trading Fund (CRTF). For the first three years, each party would contribute \$2.5 million per annum, plus a one-off contribution of up to \$2.5 million as Reserve. The amount of contributions from the

fourth year onwards would be reviewed in the third year in the light of the actual experience. The agreement would be effected through a Memorandum of Understanding (MOU) among the four parties. In addition, the CR would provide office accommodation for the FRC.

## Discussion

### *Proposal to establish the FRC*

34. Mr WONG Ting-kwong expressed the support of the Democratic Alliance for Betterment and Progress of Hong Kong (DAB) for the proposal of establishing the FRC for enhancing the oversight of the public interest activities of auditors and speeding up the investigation of suspected cases of accounting irregularities. Mr Andrew LEUNG conveyed the support of the Liberal Party for the proposal which would help maintain Hong Kong's position as a leading international financial centre, and enhance the public oversight and transparency of the self-regulatory regime of the accounting profession. Mr SIN Chung-kai said that the Democratic Party supported the proposal in principle. Miss Mandy TAM expressed support for the proposal in principle for inspiring public confidence in the integrity of the accounting profession. Ms Emily LAU said that she supported the proposal in principle.

35. While noting that members indicated support for the proposal at the Panel meetings held in June 2003 and April 2004, Mr Ronny TONG said that he inclined to object to the proposal. He expressed concern that the proposal might change the self-regulatory regime of the accounting profession and have negative impact on self-regulatory regimes of other professions, resulting in professionals being regulated by non-professionals. As the Professional Accountants (Amendment) Ordinance 2004 had enhanced the effectiveness and accountability of the regulatory regime of the accounting profession, Mr TONG questioned the need to set up the FRC. Moreover, given that HKICPA was empowered under the PAO to investigate into cases of misconduct and irregularities of the accounting profession and that SFC was empowered under the SFO to investigate accounting irregularities of listed corporations, the proposed FRC would overlap with the investigation duties of these two bodies. If necessary, the Administration should strengthen the investigatory powers of HKICPA and SFC instead of establishing the FRC. As the majority of members of the FRC were lay persons, Mr TONG expressed concern about its capability of handling complex cases of accounting irregularities efficiently. In his view, the establishment of the FRC would complicate the regulatory regime of the accounting profession and was inconsistent with the Administration's objective of streamlining the structure of the public sector. He therefore urged the Administration to re-examine the proposal and extend the period of the current consultation exercise.

36. Mr Albert HO also expressed concerns about the impact of the proposal on the self-regulatory regimes of the accounting profession and other professions, and possible overlap in the investigation duties of SFC, HKICPA and FRC. The



Chairman expressed concern about possible overlap in the investigation duties of the three bodies.

37. SFST stressed that the objective of establishing the FRC was to enhance the effectiveness, transparency and accountability of the self-regulatory regime of the accounting profession with a view to enhancing investor confidence, upgrading corporate governance and market quality. The objective was in line with the Administration's policy of maintaining Hong Kong's position as a leading international financial centre. SFST re-iterated that the proposal was put forward by HKICPA in December 2002 and had the support from the public, SFC and HKEx during the consultation conducted in September 2003. The Administration therefore took forward the proposal. It was believed that the proposal would not have negative impact on the self-regulatory regime of the accounting profession.

38. As regards the concern about possible overlap of functions of the FRC with those of HKICPA and SFC, SFST pointed out that the three bodies had different terms of reference. While the AIB would be responsible for investigating suspected irregularities of auditors of listed corporations in relation to the audit of published accounts or financial statements of such corporations and the preparation of any auditors' reports for inclusion in prospectuses, investigation of misconduct of the accounting profession outside this scope would continue to be undertaken by HKICPA. As regards SFC, its investigatory powers applied not only to auditors but also other persons involved in market misconducts. SFST re-iterated that HKICPA, SFC, HKEx and the Administration had all expressed support for the proposal and agreed to share the funding for the setting up and running of the FRC.

39. In response to Mr Andrew LEUNG's enquiry about the timetable for the setting up of the FRC, SFST said that the Administration planned to introduce the relevant bill into LegCo within the 2004-05 session. He envisaged that it would take about six months to prepare for the setting up of the FRC after passage of the Bill.

#### *Funding arrangement for the FRC*

40. Mr WONG Ting-kwong said that during the previous public consultation exercise, the DAB had expressed concern that the proposal might impose cost burden on the accounting profession and listed corporations. The DAB was pleased to note that the proposed funding arrangements contained in the Consultation Paper had addressed the concern.

41. Mr SIN Chung-kai expressed concern that the proposed annual contribution of \$10 million by CRTF, HKEx, HKICPA and SFC might not be sufficient to meet the expenses of the FRC, in particular when the FRC had to handle large and complex cases. He enquired about the details of the financial arrangements for the FRC and how the four parties concerned would share the funding requirements should the FRC face operating deficits.

42. Mr Andrew LEUNG expressed concern about insufficient funding to support the work of the FRC and to meet the substantial litigation expenses when the actions of the FRC were subject to judicial review.

43. In response, SFST advised that the proposed financial arrangements for the FRC were agreed by the four parties concerned after thorough discussion and would be effected through a MOU. It was agreed that besides the annual contributions, each party would contribute \$2.5 million to set up a Reserve for the FRC. Moreover, the FRC would have a lean structure to ensure its cost-effectiveness and that the CR would provide office accommodation for the FRC. SFST assured members that the FRC would keep in view its funding requirements and the four parties concerned would discuss further on their contributions should the FRC require further resources.

44. The Chairman enquired about the bases for working out the FRC's estimated annual operating cost and its staffing requirements. In reply, SFST said that the estimates were based on past experience of HKICPA in undertaking its investigation work. As regards staffing requirements, SFST stressed that the objective was to put in place a lean structure for the FRC so as to ensure its cost-effectiveness. The FRC might review its staffing requirements after it had come into operation for a period of time.

#### *Powers and functions of the FRC*

45. Miss Mandy TAM enquired about the details of the proposal for the FRC to follow up investigation/enquiry reports submitted by the AIB and a FRRC, the FRC's power in disclosing such reports, and the checks on such power to ensure protection of the parties involved in suspected accounting irregularities.

46. DS/FST(FS) advised that the FRC would consider the reports submitted by the AIB and a FRRC upon completion of their investigation/enquiry work. It would be for the FRC to decide on the necessary follow-up actions. The FRC might decide, after taking account of the evidence found during the investigation/enquiry, to close the case without further action, or refer the case or disclose the relevant information obtained during the investigation/enquiry to an authority, regulatory organization or a professional accountancy body in Hong Kong or elsewhere for disciplinary action, or undertake further investigation (including criminal investigation) or any other necessary actions. DS/FST(FS) also advised that having regard to the public interest and the need to maintain the transparency of the FRC, there might be circumstances justifying the publication of investigation/enquiry reports by the FRC. Hence, there would be provisions in the relevant bill stipulating that the FRC might cause the investigation/enquiry reports or any part thereof to be published. This would provide the FRC with the discretion to publish the reports as and when it saw fit. In deciding whether the reports should be published, the FRC should exercise care to ensure that such publication would not prematurely jeopardize the interests of any parties involved in the case, and would not prejudice any proceedings subsequent to the referral by the FRC to a relevant authority/body.

47. Mr Albert HO pointed out that publication of investigation/enquiry reports was important for enhancing the transparency and accountability of the FRC. He was therefore concerned about the proposal of providing the FRC with the discretion to decide whether the reports should be published. He considered that if such proposal was adopted, it was necessary to set out clearly the circumstances under which the FRC should not publish an investigation/enquiry report.

48. In response, SFST said that as the integrity of the accounting profession was of considerable concern of the public, it was believed that the FRC would seek to publish the investigation/enquiry reports wherever possible. Given that majority of the members of the FRC would be lay persons, SFST expected that they would represent public interests and exercise the discretionary power in an appropriate manner.

49. Mr Albert HO noted from paragraphs 4.5 to 4.8 of the Consultation Paper that the Administration had not proposed to set up a separate appeal tribunal to hear appeals against actions of the FRC. Pointing out that the Securities and Futures Appeal Tribunal was set up for reviewing a wide range of SFC's decisions affecting persons' rights and interests, Mr HO enquired about the reasons for the Administration's current proposal.

50. SFST advised that considerable thoughts had been given to the need and desirability of setting up a separate tribunal to handle and hear appeals against the decisions of the FRC. He pointed out that the functions and powers of the FRC would be different from those of SFC. The FRC's functions would be mainly confined to investigatory and enquiry work. If the FRC considered that there was sufficient evidence to substantiate a case or complaint, it would refer the case to the relevant authorities for follow-up actions. Unlike SFC, the FRC would not be vested with regulatory, enforcement or disciplinary powers. Given the nature of the functions and powers of the FRC, the Administration did not consider it necessary and justified to establish a separate appeal tribunal. DS/FST(FS) supplemented that the measures proposed in paragraphs 4.3, 4.4, 5.18 and 6.15 of the Consultation Paper would provide sufficient checks and balances on the powers of the FRC. It should be noted that any parties aggrieved by the action of the FRC could apply to the court for a judicial review of the action concerned.

Admin

51. In this connection, Mr Albert HO re-iterated his concern about the lack of a review mechanism on the actions of the FRC and urged the Administration to consider his views.

52. Mr Albert HO noted from paragraph 5.18 of the Consultation Paper that it was proposed that the FRC should consult the Hong Kong Monetary Authority, the Insurance Authority, SFC, or the Mandatory Provident Fund Schemes Authority as appropriate before issuing a direction to a person which was itself an authorized financial institutions, an insurer, a licensed person of SFC or an approved trustee of

MPF schemes. He enquired about the reason for the proposal and whether the FRC was obliged to follow the results of the consultation.

53. In response, SFST explained that the proposed consultation arrangement was a further measure for providing checks and balances on the investigatory powers of the FRC. As auditors' irregularities and accounting malpractices of listed corporations often involved a number of parties, the consultation arrangement was necessary to enhance communication among the relevant regulators and the FRC.

54. Mr WONG Ting-kwong expressed concern that the FRC would not be given any sanctioning powers. He was also concerned about the possible delay in taking enforcement/disciplinary actions against the parties involved in accounting irregularities in the event that upon receiving a referral by the FRC, the relevant body might have different views and undertake other actions it saw fit.

55. In response, SFST re-iterated that the majority views revealed in the consultation in September 2003 were that the function of the FRC should remain purely investigatory. The proposal of referring cases to the relevant law enforcement agency and /or professional bodies for legal and/or disciplinary actions would provide proper checks and balances on the powers of the FRC and inspire public confidence in its work.

#### *Experiences in other jurisdictions*

56. Noting that the proposal of establishing the FRC was not modelled on any accounting regulatory bodies of overseas jurisdictions, Mr Albert HO enquired whether the Administration had made reference to overseas experiences in formulating the current proposal.

57. SFST advised that the Administration had conducted research on the regulatory regimes for the accounting profession in overseas jurisdictions. The proposed FRC would suit the unique circumstances and practical situations in Hong Kong which was characterized by the self-regulatory regime for the accounting profession.

58. Mr Albert HO requested the Administration to provide an information paper on the unique circumstances in Hong Kong that justified the establishment of a FRC, and the experience of overseas jurisdictions in the regulation of accounting profession. The paper should cover the details of the regulatory regimes in overseas jurisdictions, whether the accounting profession was subject to a self-regulatory regime, the functions of the regulatory bodies involved and whether the functions were comparable to those proposed to be undertaken by the AIB and a FRRC, and the funding arrangements for performing these functions. SFST agreed to provide the paper.

Admin

#### *Institutional arrangement of the FRC*

59. Miss Mandy TAM enquired whether the Administration would consider providing the Financial Secretary with the authority to appoint members of the FRC. SFST advised that given that the FRC was to be set up as an independent statutory body, it would be appropriate for the CE to appoint its members. This arrangement was in line with that for other statutory bodies.

60. In reply to Mr Andrew LEUNG's enquiry, SFST advised that the current intention was that the FRC would not initiate investigation/enquiry relating to auditors' irregularities or non-compliance of financial reports of listed corporations happened prior to its establishment.

*Way forward*

61. Ms Emily LAU requested the Administration to report to the Panel on the outcome of the current public consultation exercise and the proposed way forward before introducing the relevant bill into LegCo. SFST undertook to do so.

Admin

**VI. Management of Government investment incomes**

(LC Paper No. RP01/04-05 — Research report on “Management of Government Investment Incomes” prepared by the Research and Library Services Division of the LegCo Secretariat

LC Paper No. CB(1)1020/04-05(06) — List of information to be provided by the Administration

LC Paper No. CB(1)1020/04-05(07) — Paper provided by the Administration

LC Paper No. CB(1)1020/04-05(08) — Extracts of Accounts of the Government for the year ended 31 March 2004)

62. The Chairman pointed out that according to the agreed arrangement between LegCo and the Administration, the Administration was required to provide a paper for a discussion item at least five clear days before the relevant Panel meeting. For this discussion item, the Administration had missed the agreed deadline (i.e. 28 February) by one day. Since the item was proposed by the Panel, the Chairman said that he had decided to retain the item on the agenda. In accordance with the agreement at the House Committee meeting on 26 November 2004, he consulted members' views on whether the item should be discussed or removed from the agenda. Ms Emily LAU said that while she had no objection to discussing the item at this meeting, she considered that the Administration should endeavour to meet the agreed deadline for

submission of papers. SFST pointed out that his colleagues had endeavoured to meet the agreed deadline but were subsequently late by one day because they were fully occupied in the preparatory work for the 2005-06 Budget. He apologized for any inconvenience caused to members. Members agreed that the item should be discussed at this meeting.

63. The Chairman informed members that pursuant to the decision of the Panel in the last session, the Research and Library Services Division (RLSD) of the LegCo Secretariat had conducted a research on management of Government investment incomes covering four selected bodies in Hong Kong namely, the Kowloon-Canton Railway Corporation (KCRC), the Airport Authority (AA), the MTR Corporation Limited (MTRCL), and the Hong Kong Science and Technology Parks Corporation (HKSTPC). At the informal meeting held on 7 January 2005, members discussed the draft research report on "Management of Government Investment Incomes" and agreed that the Administration be invited to attend this meeting for discussion of the subject. To facilitate discussion, the Administration was invited to provide before the meeting consolidated information on Government investments and investment incomes and other relevant information requested by members (LC Paper Nos. CB(1)1020/04-05(06) and (07)). The finalized research report (LC Paper RP01/04-05) was subsequently issued on 26 January 2005.

#### Presentation on the research report

64. At the Chairman's invitation, the Head, RLSD made a power-point presentation on the key points in the research report. He pointed out that the research report covered four main aspects of the selected bodies including property development and commercial activities, financial arrangements, corporate governance, and reporting arrangements. His presentation was summarized below:

##### Property development and commercial activities

- (a) Under the respective ordinances, the principal activities undertaken by KCRC and MTRCL were the construction and operation of railway systems in Hong Kong. However, in practice, the two corporations were also engaging in property and commercial developments. According to the Administration, property development had provided a source of income to the corporations to support the financial viability of railway projects and contributed to future rail patronage from the immediate catchment areas created by the property developments. The businesses that the two corporations currently engaged in were not in conflict with the goal of developing and operating the railway networks in Hong Kong.
- (b) In the cases of KCRC and MTRCL, the Government had, when assessing the land premia, adopted the "green field site" principle, under which the valuation of the full market value of a property

development site was assessed on the basis of no railway development. The rationale of this arrangement was that the railway development was considered as an investment made by KCRC or MTRCL, not the Government. The premium paid by the railway corporations was the market value of the site. However, the Hong Kong Institute of Surveyors (HKIS) and an academic were of the view that the application of the “green field site” principle would lead to a potential under-valuation of the site.

- (c) Under section 5 of the Airport Authority Ordinance, AA was empowered to engage in or carry out airport-related activity in trade, commerce or industry. The Administration explained that the activities undertaken by AA were complementary to its core service of airport operation.
- (d) The Government had granted land to HKSTPC at nominal land premium for the development of industrial estates, industrial technology centre and science park. The Administration stated that HKSTPC had not engaged in any residential and commercial development.

Extent of control over the management of Government investments

- (e) Although the selected bodies studied recorded profits in most of the past few years, they might not be required to pay dividends to the Government. Despite that the Administration was the sole or majority owner of the selected bodies, the public officers sitting on the Boards of the bodies did not have absolute influence on the Boards’ decision on dividend declaration. Moreover, LegCo was not empowered to play any role in relation to the declaration of dividends of the selected bodies and the Government’s further investment in the bodies through waiver of dividends.
- (f) There were no value for money audit studies published by the internal or external auditors of the selected bodies, or the Audit Commission.

Extent of control over the annual budgets of the selected bodies

- (g) LegCo did not have any role in scrutinizing the annual budgets of the selected bodies. For KCRC and AA, the Board-approved annual budgets were not required to be submitted to the Administration for acceptance, whereas HKSTPC was subject to such requirement.

Extent of control over remuneration packages of senior management

- (h) The selected bodies considered and determined the remuneration packages of their senior management. Neither the Administration nor LegCo had any role in this regard.

Transparency and accountability of the selected bodies

- (i) The “Accounts of the Government” for each financial year was tabled at LegCo in November each year. It contained information about the General Revenue Account (GRA) and other accounts, such as the Capital Investment Fund (CIF) and the Capital Works Reserve Fund. However, information on Government investment incomes was not clearly reflected in GRA and other accounts.
- (j) KCRC, AA and HKSTPC were required by law to table their annual reports and financial statements before LegCo. MTRCL as a listed company published the relevant information to the public. However, there was no statutory requirement for the senior management of these bodies to present their annual reports and financial statements to LegCo.
- (k) There were statutory requirements for the appointment of the Chairman and Board members of AA. However, in the cases of KCRC, MTRCL and HKSTPC, the selection criteria of the appointments were not set out in the respective ordinances. Detailed information on remuneration policies of the selected bodies was not available in the public domain. The Administration explained that the current remuneration packages of the senior executives were broadly in line with the recommended ranges set out in the consultancy report on the Review of Remuneration of Senior Executives in Statutory and Other Bodies commissioned by the Government (The Hay Group Report) and that the Administration had kept track of the remuneration levels of the senior management of the selected bodies.

*(Post-meeting note: The power-point presentation material was issued to members vide LC Paper No. CB(1)1058/04-05(01) on 8 March 2005.)*



Presentation by the Administration

65. Upon the Chairman' invitation, SFST briefed members on the Administration's policy and work regarding management of Government investment incomes. He highlighted the following points:

- (a) The purpose for the Government to invest under CIF in various projects involving public interest, such as large scale infrastructural projects, was to enable the implementation of the projects through Government's participation so as to achieve the relevant policy objectives. Given that the projects normally involved substantial costs and risks, and long periods of investment, the private sector was not willing to invest without Government's participation and support. Two typical examples of such projects were the projects for the construction and development of railway networks and airport facilities. Public interest instead of investment returns was the major consideration for the Government to invest in such projects. By and large, Government's investments in such projects had been able to achieve the relevant policy objectives so far.
- (b) The Government had endeavoured to ensure the proper use of public moneys and reasonable returns from its investments. A proper balance was maintained between the need to provide flexibility for the effective and efficient operation of public corporations and the need to monitor their work. The Government had been participating in the decision-making process of public corporations through appointment of Board chairmen and appointment of lay persons and public officers as directors of the Boards, and approval of the corporations' annual work plans and budgets.
- (c) On the basis of the "Big market, small government" principle, the Government would constantly review its role in various projects involving public interest and the need for it to continue to participate in the projects. It would also explore whether there were other more effective modes of Government participation for achieving the policy objectives.

Discussion

*Declaration of interest*

66. Mr Abraham SHEK declared interest that he was a director of the Board of KCRC and the Board of the Hong Kong Mortgage Corporation Limited.

*Dividend payout policy of public corporations*

67. Miss Mandy TAM expressed concern about the lack of mechanisms to govern the dividend payout policy and remuneration levels of the senior management of the selected bodies covered by the research report. She enquired about the Administration's plan and timetable for making improvement in these areas.

68. SFST pointed out that the remuneration levels of the senior management of public corporations should be on a par with those of comparable bodies in the private sector. In this connection, public corporations wholly owned by the Government were required to follow the recommendations of the Hay Group Report in determining the remuneration levels of their senior management. It should be noted that some public corporations, including AA and KCRC, had set up remuneration committees comprising independent members of the Boards for formulating remuneration policies to enhance transparency of the corporations. As regards the dividend payout policy, SFST pointed out that the Boards of the selected bodies were empowered under the respective ordinances to declare and pay dividends to the Government. In making the decision, the Boards would take into account the overall financial position of the selected bodies and other relevant factors.

69. Ms Emily LAU appreciated the efforts of RLSD in conducting the research. She noted that the research report had identified deficiencies in the management of Government investment incomes and urged the Administration to make improvement accordingly. In particular, she considered that the Administration should put in place a proper mechanism to govern the dividend payout policy of public corporations. In this connection, Ms LAU enquired about the reasons why KCRC, AA and HKSTPC had not paid any dividends to the Government in some of the years when profits were recorded. She also considered that cash dividends from public corporations should be credited to GRA for addressing budget deficits and meeting expenses of the programmes which would benefit the public. Noting that HKSPC had signed a shareholder agreement with the Government in 2004 covering the dividend payout policy, Ms LAU suggested that the same arrangement should be adopted for other public corporations. Referring to the case of MTRCL's Penny Bay Rail Line project where the Government had injected funds to the project through waiver of dividends payable by MTRCL without seeking LegCo's approval, Ms LAU considered it necessary to stipulate in the dividend payout policy the circumstances under which dividends payable to the Government should be paid or waived.

70. SFST pointed out that details of Government's investments were set out in the annual accounts of CIF as part of the "Accounts of the Government" and information on the dividends received was published in the annual reports of the public corporations concerned which were accessible to the public. He re-iterated that the Boards of public corporations, in making the decision of whether dividends should be paid to the Government in a particular financial year, would take into account the overall financial position of the corporations and other relevant factors. The relevant factors might include the business prospects, the need for cash to meet capital and recurrent expenditure, as well as the outstanding and anticipated financing

obligations of the corporations. For instance, AA had paid dividends to the Government in 2004-05, the year when profits were recorded. In the case of KCRC, dividends were paid to the Government in 2003-04 when the corporation's financial position had been improved upon completion of a number of development projects. Moreover, MTRCL had paid scrip dividends to the Government in 2001-02, 2002-03 and 2003-04. SFST considered it inappropriate to put in place a rigid mechanism stipulating a fixed amount of dividends payable by public corporations.

71. Mr Ronny TONG enquired about the Government's investments on and returns from the Cyberport project. SFST advised that the Administration had provided the relevant information to the LegCo Panel on Information Technology and Broadcasting in December 2004.

*Government's land grant policy and the impact on government revenue*

72. Members considered that land and revenue generated from its sale were important sources of income for the Government. The Administration should ensure the effective use of the limited land resources and that its land grant policy was able to safeguard public interest, maximize financial gains for the community, achieve fair competition and maintain market stability.

73. Referring to the government policy of subsidizing commercially operated infrastructural projects in the form of land, such as the Cyberport project and the proposed West Kowloon Cultural District Development project, Mr Ronny TONG was concerned that such a policy was in contravention of the Basic Law. Apart from the Basic Law considerations, he considered it important for the Administration to ensure that the land grant policy was able to safeguard public interest. In this connection, he enquired whether the Administration would set up a transparent and professional mechanism for:

- (a) assessing the value of the land to be granted for subsidizing a commercially operated infrastructural project and the financial gains to be achieved by putting up the land for sale through open bidding; and
- (b) assessing the rate of return for the Government on the assumption that such a subsidy had been granted to the project.

74. Mr Abraham SHEK was of the view that the policy of subsidizing commercially operated infrastructural projects in the form of land was a remnant of the colonial era and no longer suited the present day circumstances in Hong Kong. He pointed out that as MTRCL and KCRC had been undertaking activities not relating to their core business of developing and operating the railway networks in Hong Kong, it was unjustified for the Government to apply the policy to the two corporations, in particular MTRCL which had become a listed corporation in October 2000. He considered that the Administration should critically review the policy.

75. Mr SIN Chung-kai and Mr Albert HO considered that the Government should stop subsidizing MTRCL's projects in the form of land after the listing of the corporation in October 2000. Mr HO pointed out that he had expressed similar views when LegCo scrutinized the Mass Transit Railway Bill in the 1999-2000 session.

76. Mr SIN Chung-kai also considered that the Administration should ensure that the land granted to public corporations was put into effective use for the development of their core business, such as the large piece of land on the Airport Island granted to AA. He suggested that any part of the land which had not been used for the core business of AA should be returned to the Government and put up for sale through open bidding.

77. On the concern about the policy of subsidizing commercially operated infrastructural projects in the form of land, SFST stressed that the Administration would consider the merits and needs of individual projects before making a decision on land grants. As regards the suggestion of setting up a transparent and professional mechanism for assessing the value of the land, SFST pointed out that it would be extremely difficult to make the assessment which would involve a host of variable factors.

78. The Deputy Secretary for Financial Services and the Treasury (Treasury) (DS/FST(T)) supplemented that the Administration entered into agreements with the corporations in respect of land grants for individual projects. For railway development projects initiated by KCRC and MTRCL, the Administration would consider on a case-by-case basis whether it was in the public interest to grant land to support the development projects. In seeking funding approval from the Finance Committee of LegCo for the railway development projects, it was the normal practice for the Administration to brief Members on the details of the projects including the implications of any land grant. In the case of MTRCL, the Administration had disclosed the policy and intention of providing land grants in the prospectus for the listing of MTRCL.

79. Ms Emily LAU shared HKIS's concern that the application of the "green field site" principle in assessing the land premia to be paid by MTRCL and KCRC imposed an important assumption (i.e. no railway development) into the valuation process and thus would have significant implications on the premium assessment (paragraph 6.5.4 of the research report). In other words, it would under-estimate the value of the land. Ms LAU considered that the application of the principle had resulted in the Government's provision of indirect subsidies to the two railway corporations and in the loss of revenue. She requested the Administration to address this concern and provide justifications for applying the principle in premium assessment.

80. Mr Abraham SHEK shared Ms Emily LAU's views. He also requested the Administration to explain the basis for calculating the amounts of land premia paid by MTRCL and KCRC for each of the development projects set out in Appendices II and VII to the Administration's paper issued in February 2005 (LC Paper

No. CB(1)1020/04-05(07)).

81. In response, SFST pointed out that although the application of the “green field site” principle might lead to a lower amount of land premium, it was important to note that the principle had been adopted in recognition of the fact that the railway development was an investment made by the railway corporation concerned and not by the Government. The principle was not applicable to other property developers.

*Transparency and accountability of public corporations*

82. Mr Albert HO expressed concern about the accountability of the Boards of public corporations to the Government and the public. He was concerned that as public corporations were operated under prudent commercial principles and information relating to their operation was normally not disclosed, there was no channel for LegCo or the public to monitor the work of the corporations. Moreover, public corporations were not obliged to take account of public interest in their operation. In this connection, Mr HO considered that the Administration should strengthen the role of public officers appointed to the Boards of public corporations in ensuring the protection of Government investment interests.

83. Mr LEE Cheuk-yan shared Mr Albert HO’s concern. He was of the view that commercial operation of public corporations should not override public interest.

84. SFST advised that while public corporations operated under prudent commercial principles, they were mindful of the need to maintain public accountability. The appointed directors in the Boards of public corporations, including lay persons or public officers, had the fiduciary duties to act honestly and in good faith for the benefit of the corporations under the common law. Besides monitoring the operation of the corporations to ensure the protection of Government investment interests, the public officers appointed as directors provided their views in their personal capacity to steer the development of the corporations. Government policies and public interest issues were pursued through separate, formal lines of the communication between the corporations and the policy bureaux concerned. On the accountability of the public officers concerned, SFST emphasized that they were answerable to LegCo on matters under their respective policy purview. SFST assured members that the Boards of public corporations had operated with accountability and transparency. Their representatives attended meetings of the relevant LegCo Panels from time to time to explain the work of the corporations and discuss with Members on issues of concern. In this connection, Mr LEE Cheuk-yan expressed dissatisfaction that Members’ views and requests were often not taken on board by public corporations.

85. Mr Albert HO and Mr SIN Chung-kai noted that while public corporations had employed external auditors to audit their financial statements, they were not subject to value for money audits conducted by the Audit Commission. They considered that public corporations, except MTRCL which was a listed company, should be required to

conduct value for money audit to ensure that the public moneys invested in the corporations were properly used, and that the audit reports should be published to enhance transparency. With a view to enhancing transparency of public corporations, Ms Emily LAU also suggested that the internal and external auditors' reports of public corporations should be disclosed to the public.

86. In response, the Permanent Secretary for Financial Services and the Treasury (Treasury) said that the internal and external auditors employed by public corporations would audit the corporations' accounts in accordance with accounting standards promulgated by the Hong Kong Institute of Certified Public Accountants. DS/FST(T) supplemented that the internal audit departments of public corporations reported directly to the Boards of the corporations on accounting matters including value for money issues, and therefore fulfilled similar functions as those of the Audit Commission. Public corporations also set up audit committees to scrutinize the reports of the internal and external auditors.

#### *Management of investment incomes of the Housing Authority*

87. Mr Albert CHENG expressed concern about the monitoring of the investment of the proceeds of the proposed listing of the Link Real Estate Investment Trust (Link REIT) by the Housing Authority (HA). Referring to a press report that HA planned to invest the proceeds on real estate securities, Mr CHENG considered it important for the Government to ensure that such investments should achieve a comparable rate of return as that generated from rental of the car parks and shopping malls before the implementation of the divestment project.

88. SFST pointed out that HA, being a statutory body, had full autonomy in disposing of its assets. He and some LegCo Members as members of HA had been monitoring HA's investments. As regards the listing of the Link REIT, HA had established a Supervisory Group on Divestment (SGD) to steer and monitor the divestment project. SFST said that he was not aware of any concrete plan of SGD for investing the proceeds of Link REIT. However, he had accepted invitation to join SGD and would endeavour to contribute to its work.

#### Follow-up actions

89. Members were not so convinced of the explanation given by the Administration. They requested the Administration to provide a paper to address their concerns raised in paragraphs 69, 82 and 85 above regarding the dividend payout policy of public corporations, role of public officers appointed to Boards of the corporations and value for money audits of the corporations.

*(Post-meeting note: The paper provided by the Administration (LC Paper No. CB(1)1189/04-05(03) was issued to members on 1 April 2005.)*

90. Ms Emily LAU suggested that the Panel should consider holding a joint

meeting with the Panel on Planning, Lands and Works (PLW Panel) to follow-up on the issues relating to land grant policy and the impact of the policy on government revenue. The Chairman requested the Administration to provide a paper to address the points of concern raised by members in paragraphs 72, 73, 74, 76, 79 and 80 above. He directed that the Chairman of the PLW Panel be invited to consider Ms LAU's suggestion.

*(Post-meeting notes:*

- (a) The Administration was requested to provide a paper to address the points of concern raised by members (LC Paper No. CB(1)1189/04-05(02)) by 15 April 2005.; and
- (b) The joint meeting of the Panel on Financial Affairs and the Panel on Planning, Lands and Works is scheduled for 24 May 2005, from 2:30 pm to 3:30 pm)

91. SFST said that he would reflect members' views and suggestions expressed at the meeting to the relevant Bureau and take follow-up actions as requested in paragraphs 89 and 90 above.

*(Post-meeting note: The paper provided by the Administration (LC Paper No. CB(1)1395/04-05(01)) was issued to members on 27 April 2005.)*

## **VII. Any other business**

92. There being no other business, the meeting ended at 1:00 pm.

Council Business Division 1  
Legislative Council Secretariat  
5 May 2005