

A. Introduction

The Audit Commission ("Audit") conducted a review to examine the economy, efficiency and effectiveness of the administration of the DesignSmart Initiative ("DSI") managed by the Innovation and Technology Commission ("ITC"). The review focused on the following areas:

- corporate governance and administration of the HKDC;
- management of projects funded by the Design Support Programme ("DSP");
- promotion of design by the Hong Kong Design Centre ("HKDC");
- administration of the Design Incubation Programme; and
- overseas practices in the promotion of design.

B. Corporate governance and administration of the HKDC

Attendance of directors at Board/Committee meetings

2. The Committee noted that the HKDC, established in 2001, was governed by a Board of Directors ("Board"). The Finance and Administration Committee ("FAC") and the Business Development Committee of the HKDC were set up in June 2007 to assist the Board to conduct its business. As revealed in paragraph 4.5 of the Director of Audit's Report ("Audit Report"), from March 2007 to June 2008, the attendance rates of some directors at Board/Committee meetings were low. Furthermore, at three (60%) of the five FAC meetings held during the period, the quorum requirement was not met. This might render the decisions made at these meetings invalid.

3. The Committee also noted Audit's concern in paragraph 4.6 of the Audit Report that the overall effectiveness of the Board/Committee might be compromised if a large number of directors representing different sectors of the community did not attend meetings to participate in the decision-making process.

4. Against the above background, the Committee enquired about:

- the views of the HKDC on the poor attendance of some directors at Board/Committee meetings;
- the measures that the HKDC would take to improve the situation and ensure that the quorum requirement would always be met at all meetings in future; and

- for the decisions made at the three FAC meetings without the necessary quorum, the follow-up actions that had been taken by the HKDC.

5. **Hon Victor LO Chung-wing, Chairman, Board of Directors ("Board Chairman"), HKDC**, stated that:

- the HKDC was very concerned about the low attendance rates of its directors. He had issued a letter to all directors to urge them to make efforts to attend future Board/Committee meetings; and
- the directors were prominent individuals with experience and professional knowledge in the design and creative industries and related fields. They included Executive Council members, Legislative Council members and owners of small design firms, etc. They had a lot of business commitments and some travelled overseas frequently. Hence, it was difficult for them to attend Board/Committee meetings. To improve the situation, different measures had been taken, including setting the date and time of meetings three months ahead so that members could plan their schedules in advance.

6. **Mr Allan CHIANG, Chief Executive Officer, HKDC**, stated that:

- the attendance rates at the last two Board meetings had increased to more than 70%;
- apart from attending Board/Committee meetings, the directors also contributed to the work of the HKDC through other means. For example, they provided expert views on strategic issues, directly participated in promotional campaigns such as fund-raising activities, and assisted the HKDC through their personal and professional networks; and
- the issues considered by the FAC were mostly proposals and the FAC's decisions had to be reported to the Board for approval. The HKDC had reviewed the decisions made at the three FAC meetings without a quorum and found that, except for the issue mentioned in paragraphs 4.31 and 4.32 of the Audit Report, no rectification was required for other decisions as they had either been re-affirmed by the Board or superseded by subsequent events. The quorum requirement was met at all FAC meetings held subsequently.

7. In response to the Committee's enquiries, the **Chief Executive Officer, HKDC** stated at the public hearing and in his letter of 9 January 2009 (in *Appendix 17*) that:

- at present, the HKDC did not publish the attendance records of Board/Committee meetings in its annual reports. He considered this a good idea and would put it up to the Board for consideration;
- in addition to the measures set out in paragraph 4.16(a) of the Audit Report, the following measures had been taken to improve the attendance of directors at Board/Committee meetings:
 - (a) choosing a meeting venue that better suited the convenience of the majority of the directors. It had now been decided that half of the meetings would be held at the HKDC office in Kowloon Tong and the rest in Wan Chai, which would be a more convenient location;
 - (b) sending reminders to the directors before the meetings; and
 - (c) exploring the use of tele-conferencing facilities to secure the participation of directors who could not be present at the meetings; and
- to ensure that the quorum requirement would be met at all meetings in future, the HKDC would confirm the number of directors available to attend the meetings two days in advance of the respective meetings.

8. According to paragraph 4.5(b) of the Audit Report, during his tenure as one of the two government directors, the Deputy Secretary for Home Affairs had attended only three (43%) of the seven Board meetings. Moreover, six non-government directors had a low attendance rate (below 40%) at Board/Committee meetings. In particular, three of them had an attendance rate of 25% or below. The Committee asked the Secretary for Commerce and Economic Development:

- whether she was satisfied with such a low attendance rate;
- the criteria for appointing directors to the Board of the HKDC; and
- whether she would still consider reappointing those directors with poor attendance record to the Board upon expiry of their current tenure.

9. **Hon Mrs Rita LAU NG Wai-lan, Secretary for Commerce and Economic Development**, responded that:

- it was the Government's objective to develop Hong Kong as the region's design hub and the HKDC had been the Government's main partner in promoting design. To achieve its objective, the Government had to draw on the expertise and experience of Hong Kong's design talents. In considering

the appointment and reappointment of the directors of the HKDC, her primary concern would be the individuals' qualifications and experience, as well as their ability to make positive contribution to the Board, having regard to the need of the Board;

- she would certainly take into account the attendance rates of the directors in considering approval of their reappointment in future, but this would not be the only factor of consideration. While directors should have been informed of the date and time of a meeting in advance, it did happen sometimes that they could not attend the meeting due to other urgent business. Hence, their reasons for absence should also be taken into consideration; and
- the Commissioner for Innovation and Technology was one of the two government directors on the Board and served as the link between the Board and the Government. The Commissioner had the responsibility to report to her the operation of the Board and to see to it that a mechanism was in place to ensure proper use of the public funds allocated to the HKDC.

10. The **Board Chairman, HKDC** supplemented that:

- during the reorganisation of the Board in 2007, he had had detailed discussion with the Commissioner for Innovation and Technology about the requirements of Board members. It was agreed that Board members should be experienced individuals from the creative industries, design enterprises or relevant education institutions. It was also recognised that they should have concepts of management of public funds as the HKDC received a large amount of government funds and ran many government-subsidised projects; and
- for those individuals who were well-qualified but could not afford the time or might not be suitable to serve as directors, the HKDC would still enlist their assistance through other means, such as by setting up committees at different levels and inviting them to join.

11. As reported in Note 5 of paragraph 4.2 of the Audit Report, the Deputy Secretary for Home Affairs ceased to be a director of the HKDC in March 2008. Paragraph 4.15(b) further stated that the ITC and the Home Affairs Bureau ("HAB") had been in discussion on the more appropriate capacity for any representative of the HAB to hold on the Board. The Committee asked about the result of the discussion.

12. In his letter of 30 December 2008 in *Appendix 18*, the **Secretary for Home Affairs** informed the Committee that the HAB had held preliminary discussion with the ITC. The ITC was agreeable to the HAB sending a representative to sit on the Board of the HKDC in the capacity of an observer. The ITC would consult the Board of the HKDC further before institutionalising the arrangement.

13. The Committee noted that the HKDC, being an organisation in the creative industries, should enjoy a high degree of freedom and flexibility. At the same time, being a government-funded organisation, it was expected to observe government rules and regulations. The Committee asked how the Administration struck a fair balance in designing the governance structure of the HKDC.

14. **Mr Eddy CHAN Yuk-tak, Commissioner for Innovation and Technology**, responded that he was only one of the 20-odd directors on the Board of the HKDC. His role was to set clear guidelines on the amount of funds to be allocated to each project and to ensure proper utilisation of the public funds allocated to the HKDC.

15. The **Secretary for Commerce and Economic Development** added that:

- there should not be a conflict between promotion of design and being accountable in spending public money as long as the powers and responsibilities of different parties were clearly stipulated. For instance, it was acceptable for the Board to delegate certain authority to a committee or director provided that the decision was made with transparency, free from personal influence; and
- regarding the HKDC's formulation of policy on development of design, the Administration believed that it should rely on talents in the trade to take the lead and should not intervene. On the other hand, as public money was involved, the government directors on the Board had the responsibility to put in place a proper system and mechanism to ensure that public funds were well-spent.

Hiring of staff

16. The Committee noted that according to the HKDC's Corporate Governance Manual, all staff should be appointed through an open recruitment process. The Board's prior approval was needed for the creation of new posts. The ITC's approval was also needed if the creation of new post constituted a manpower variation. However, Audit found that in a case involving the creation of new post, which constituted a manpower variation, approvals of the Board and the ITC were only sought after the appointee had

started working in the HKDC, and open recruitment had not been conducted (paragraphs 2.59 and 4.19 of the Audit Report refer). The Committee asked why the HKDC did not comply with the requirements of its Corporate Governance Manual and how the HKDC would rectify the situation.

17. The **Chief Executive Officer, HKDC** explained that:

- the case referred to in paragraph 2.59 of the Audit Report was very exceptional. It involved the recruitment of the HKDC's project director in March 2007. Before being offered the new permanent project director post, the staff concerned had been a contract consultant for the Business of Design Week ("BODW"), the flagship project of the HKDC, for two years. The HKDC decided in March 2007 that it would hold the next BODW in December 2007. Because of the urgency of the situation, the need to ensure work continuity and knowledge retention/transfer, as well as the robust job market at the time, the HKDC considered that open recruitment would unlikely yield a better candidate. Prior approval from the Board and the ITC was not obtained in time because of the urgent need to recruit the staff; and
- the exceptional arrangement had been approved by the FAC, and covering approval was subsequently granted by the ITC. The HKDC would ensure that requirements regarding the hiring of staff as stipulated in the Corporate Governance Manual would always be complied with in the future.

The Administration's responsibility

18. To ascertain whether the ITC had properly discharged its responsibility of monitoring the HKDC to ensure proper utilisation of public funds, the Committee asked about the actions that the ITC had taken to improve the administration of the HKDC since the reorganisation of the Board structure in March 2007.

19. The **Commissioner for Innovation and Technology** stated at the public hearing and in his letter of 7 January 2009 in *Appendix 19* that:

- the HKDC was a private non-profit making company formed in 2001 by founding design associations. Since the establishment of the HKDC, the Commissioner for Innovation and Technology had been participating in its governing institutions to provide Board level advice and oversight to the company. For instance, in 2006, the ITC provided substantial input in revamping the Corporate Governance Manual of the company. However, the daily operations of the HKDC, as for any private company, were the responsibilities of the management;

- before the incumbent Chief Executive Officer of the HKDC was employed in June 2007, the HKDC did not have a full-time chief executive officer. A lot of problems had occurred in the HKDC's operations. The systems and management of the HKDC had improved since July 2007 under the supervision of a full-time chief executive officer;
- when the Administration sought the Legislative Council's approval in May 2007 to provide \$100 million to support the HKDC's operations, the Administration proposed that there should be an adequate control mechanism. Such a mechanism included a revamp of the composition of the HKDC's Board to ensure a balanced representation of stakeholders and an independent overview on the HKDC's operation; and a funding agreement which provided, inter alia, that the HKDC should submit annual plans and three-year business plans, audited accounts, performance indicators and assessment, quarterly disbursements subject to acceptance of progress, setting of annual income targets and rules on the virement of funds, etc; and
- the Administration had since been monitoring the HKDC's operations accordingly. As shown in the Audit Report (e.g. paragraph 4.20), the ITC had been playing an active role in monitoring the HKDC's compliance with the Corporate Governance Manual and had on a number of occasions reminded the management of the need to improve compliance. A further example was that the ITC, at a regular liaison meeting with the Independent Commission Against Corruption in June 2007, proactively requested that a study on the governance and project administration of the HKDC be conducted, to ensure that adequate corruption prevention safeguards were in place. The study was completed in May 2008 and the ITC had since been working with the HKDC on the follow-up actions.

20. It appeared to the Committee that it would be preferable for the HKDC, a small organisation with an establishment of only 31 staff, to strengthen its corporate governance and internal control by system design. The Committee therefore enquired whether the Administration would consider taking such measures as appointing persons with knowledge and experience in corporate governance as directors of the HKDC, and asking them to pay attention to corporate governance issues.

21. The **Secretary for Commerce and Economic Development** stated that the suggestion was in line with her thinking. In fact, the Government had appointed a professional accountant to the Board who served as the Chairman of the FAC. He would oversee the HKDC's internal audit mechanism. It was expected that with his experience in corporate governance and professional background, he would be able to assist the Board in enhancing the governance of the HKDC.

Management of potential conflicts of interest

22. The Committee noted from paragraphs 4.9 to 4.11 of the Audit Report that the HKDC adopted a "one-tier reporting system" for its directors to declare and report conflicts of interest, although it met, to a large extent, the criteria for adopting a "two-tier reporting system" set out in the guideline issued by the HAB. Audit pointed out that as many HKDC directors came from the design trade, potential conflicts of interest might arise when issues about the promotion of design and innovation were discussed at the Board/Committee meetings. As the two-tier reporting system was more stringent than the one-tier reporting system and could better safeguard the HKDC's interests, the Committee asked:

- why the Administration had not required the Board to adopt the system in accordance with the HAB's guideline; and
- whether the HKDC would adopt the two-tier reporting system.

23. The **Secretary for Commerce and Economic Development** stated that the HAB's guideline was applicable to advisory and statutory bodies. As the HKDC was a private company, it was not mandatory for it to adopt the two-tier reporting system. However, she supported the Board to adopt the system to enhance the prevention of conflicts of interest. In fact, the system not only could safeguard the HKDC's interests, but also the directors' interests. The Commissioner for Innovation and Technology, in his capacity as a director of the HKDC, would recommend adoption of the system to the Board.

24. The **Board Chairman, HKDC** stated that:

- the Board had had detailed discussion on the adoption of the two-tier reporting system at its last meeting. Reference had been made to other organisations which adopted this system. The directors held different views on the matter and wished to have more time for consideration. The matter had been set down for discussion by the Board again at its next meeting; and
- he personally supported the system and would strive to obtain the Board's agreement to adopt it.

25. In his letter of 9 January 2009, the **Chief Executive Officer, HKDC** informed the Committee that the Board decided at its meeting on 24 December 2008 to adopt the two-tier reporting system for declaration of interests by its directors.

C. Management of projects funded by the DSP

Management of DSP projects by the ITC

26. According to paragraph 2.11 of the Audit Report, Audit's examination of the records of 27 meetings of the DSI Assessment Panel ("DSI Panel") held from October 2004 to June 2008 showed that in 20 (74%) meetings, declarations of conflicts of interest had been made. However, contrary to the guidelines issued by the ITC to the DSI Panel members, in 17 (63%) meetings, the members concerned were allowed to participate in the discussion of the applications in which they had declared an interest. In 12 (44%) meetings, these members were even allowed to vote in the approval of the applications concerned.

27. The Committee asked:

- why the ITC did not enforce its guidelines on conflicts of interest and allowed a member who had declared an interest in an application to participate in the discussion, and even vote in the approval, of the application concerned;
- how the ITC would ensure compliance with the requirements stipulated in the guidelines; and
- whether the ITC adopted the two-tier reporting system for members of the DSI Panel to declare and report conflicts of interest and, if not, whether the ITC would do so.

28. In response, the **Commissioner for Innovation and Technology** said that:

- the ITC had been too lax in enforcing the guidelines on conflicts of interest. In the cases mentioned in paragraph 2.11 of the Audit Report, after the members concerned had declared an interest, the DSI Panel decided to allow them to participate in the discussion having regard to the fact that they did not have a pecuniary or commercial interest in the applications. They were only related to the applicant organisations. For example, a member was a council member of a university and the application was made by a design programme of the university. In the circumstances, the DSI Panel considered the conflicts of interest not serious and the member could contribute his professional views by participating in the discussion of the application. However, he agreed that such arrangement could not satisfy the public expectation for a stringent system that could effectively prevent the occurrence of conflicts of interest;

- as explained in paragraph 2.14(c)(ii) of the Audit Report, of the 12 cases in which members with declared conflicts of interest were allowed to vote, the recommendations of the DSI Panel were arrived at through consensus or by majority view. Voting as such had not occurred at the meetings; and
- in future, the ITC would strictly enforce the guidelines on conflicts of interest and would not allow any member who had declared an interest in an application, or who was related to an applicant organisation in any way, to participate in the discussion of the application concerned. The member would not be given the discussion document.

29. Regarding adoption of the two-tier reporting system for declaration of interests by the DSI Panel members, the **Secretary for Commerce and Economic Development** and the **Commissioner for Innovation and Technology** responded that:

- the DSI Panel was established to assist the ITC in assessing applications and monitoring progress of projects under the DSP. It was chaired by the Commissioner for Innovation and Technology and comprised prominent people selected from related fields. Unlike directors of the HKDC who had the authority to approve funding applications, the DSI Panel members only played an advisory role and the approval authority was vested in the Commissioner for Innovation and Technology. Hence, the arrangements for declaration of interests by the DSI Panel members were not necessarily the same as those for directors of the HKDC;
- all DSI Panel members were required to declare if there was a conflict of interest when they attended the DSI Panel meetings. This requirement was made known to the members when they were appointed to the DSI Panel. In addition, before each DSI Panel meeting, the ITC reminded the attending members in writing with a standard form to declare interests. The ITC would ensure that, in accordance with established guidelines, members who had made a declaration of interest on a particular agenda item would not be allowed to participate in the discussion of that item; and
- the Administration saw the merit of adopting the two-tier reporting system to avoid any perceived or actual conflicts of interest for the sake of transparency and accountability. It would seriously consider introducing the system for the DSI Panel members.

30. The **Commissioner for Innovation and Technology** informed the Committee in his letter of 7 January 2009 that the two-tier reporting system for all DSI Panel members had been introduced with effect from 1 January 2009.

31. The Committee noted from paragraph 2.3 of the Audit Report that, in seeking funding approval for the DSI in June 2004, the Administration informed the Finance Committee of the Legislative Council that the four DSP funding schemes, namely the Design Research Scheme ("DRS"), Design-Business Collaboration Scheme ("DBCS"), Professional Continuing Education Scheme ("PCES") and General Support Scheme ("GSS"), would benefit about 700 projects over five years. However, up to 30 June 2008 (i.e. four years after launching the DSI), only 169 projects (24% of 700 projects) were approved under the DSP. The Committee asked:

- why the total number of projects which benefited from the DSP was so much lower than that expected; and
- whether the ITC had taken any action to improve the utilisation of the funding schemes.

32. The **Commissioner for Innovation and Technology** explained that:

- of the four funding schemes, the number of projects benefited from the GSS was almost the same as expected, while the utilisation rates of the other three schemes were lower than estimated. This was probably because the Administration had over-estimated the number of projects that would benefit by such a new initiative. It turned out that the response was not as warm as anticipated. Moreover, it took a period of time to introduce the programme to potential applicants and the design trade;
- to improve the utilisation of the DSP, the ITC had reviewed the operation of the funding schemes. The DBCS was reviewed in 2007. Following the review, the rules were revised to allow design companies and small-and-medium-sized enterprises ("SMEs") to become DBCS project co-applicants and SME applicants would be eligible for a maximum grant of \$100,000 for four projects at most. The DRS was reviewed in 2008. As a result of the review, the theme approach was abolished and a new approach was adopted for soliciting DRS project applications. Under the new approach, DRS applications with any themes would be accepted throughout the year. It was expected that the new approach would encourage more DRS applications; and
- the ITC would conduct a review of the PCES later to identify ways to encourage more applications.

33. The **Secretary for Commerce and Economic Development** supplemented that as at December 2008, there were 200 projects approved under the four DSP funding schemes. While the number was still smaller than the target of 700, the total number of beneficiaries of these projects would be multiples of the number of 200. This was because activities such as design research would benefit the industry as a whole, and events organised under the funding schemes were attended by many local and overseas participants.

34. As reported in paragraphs 2.15 and 2.16 of the Audit Report, the DSP funding guidelines issued by the ITC required that fund recipients should submit a project completion report to the ITC within two months after the project is completed. However, Audit's review of the ITC's records found that there were delays in the submission of project completion reports.

35. In addition, the Committee noted from paragraph 2.20(a) of the Audit Report that the DSI Panel agreed at its meeting held in July 2008 that a warning letter should be sent to a DBCS fund recipient who had not submitted the project completion report over three months after the due date. The Committee asked whether the ITC had issued any warning letter to the 19 projects referred to in paragraph 2.16(a), whose reports had been overdue for more than three months.

36. The Committee further asked whether the ITC would require fund recipients of the other three funding schemes, in addition to those of the DBCS, to complete and return post-project evaluation questionnaires, as recommended by Audit in paragraph 2.19(b).

37. The **Commissioner for Innovation and Technology** replied at the public hearing and in his letter of 22 January 2009 (in *Appendix 20*) that:

- the 19 projects consisted of 18 under the DBCS and one under the GSS. As at 22 January 2009, the ITC had not issued any warning letter to these projects because:
 - (a) three projects had since been withdrawn by the applicants;
 - (b) one project had sought and obtained a two-week extension of the completion report submission due date and submission was made within this period. There were some clarifications and technical issues in the accounts to be considered; these had now been resolved and the revised completion report submitted;

- (c) eight projects had applied for and been approved extended deadlines for project completion or submission of completion, and the concerned completion reports had been submitted within the extended timeframe; and
 - (d) seven projects had applied for and been approved extended deadlines for project completion or submission of completion, and their respective extended timeframes had yet to expire;
- the fund recipients of all the four schemes were required to submit project completion reports. However, only the fund recipients of the DBCS were required to submit post-project evaluation questionnaires. This was because the ITC wanted to obtain more information on whether or not the DBCS projects were successful in transforming design activities into tradable deliverables. When the review of the DBCS commenced in July 2007, the ITC conducted a questionnaire survey to gauge the views of various stakeholders; and
 - no questionnaire survey had been conducted on the other three funding schemes. As the ITC would evaluate the other funding schemes in 2009, it would also require the relevant fund recipients to complete and return post-project questionnaires.

38. According to paragraph 2.21 of the Audit Report, in seeking funding approval for the DSI in June 2004, the Administration informed the Finance Committee that it intended to review periodically the operation of the DSP. However, paragraph 2.22 revealed that of the four DSP funding schemes, the ITC had only completed reviewing the DRS and the DBCS by June 2008, while no review had been conducted on the PCES and the GSS. It appeared to the Committee that if the ITC had conducted reviews on the four DSP schemes periodically as undertaken, it might be able to identify at an earlier time areas for improvement that could help optimise the utilisation of the schemes.

39. The **Commissioner for Innovation and Technology** said he agreed that if the schemes had been reviewed earlier, the ITC might have recognised earlier that the number of projects benefited from the schemes was lagging far behind the target. On the other hand, as the DSP was only launched in 2004, the ITC considered it more appropriate to allow the schemes to operate for a longer time before reviewing them, so that more experience in their operation could be accumulated. The ITC considered it opportune to start reviewing the schemes from 2007, about three years after the DSP had been launched. The ITC would review the PCES and the GSS, starting from the first half of 2009.

40. In response to the Committee's enquiries about the improvement brought about by the review of the DBCS, the **Commissioner for Innovation and Technology** stated in his letter of 7 January 2009 that:

- the DBCS review exercise was started in July 2007. To better tap the views of various stakeholders, the ITC had conducted a questionnaire survey, a discussion session and two special DSI Panel meetings during the review period from July 2007 to June 2008. The new arrangements for DBCS were then implemented in June 2008; and
- there had been an increasing trend for DBCS applications. Approved applications for the DBCS rose from five in 2005 to 31 in 2006 and 57 in 2007. For 2008, there were respectively 41 and 35 approved projects before and after the new arrangements of the DBCS were implemented in June 2008.

GSS projects undertaken by the HKDC

41. The Committee noted that Project 9707 was a GSS project initiated by the HKDC to commemorate the 10th anniversary of Hong Kong's return to China. It aimed to honour the achievements and excellence of the Hong Kong design industry in the period 1997 to 2007. As part of Project 9707, 10 international brands and 10 Hong Kong designers were invited to produce 10 collaborative creative products. These products were exhibited in Hong Kong and the Mainland, and were sold in limited quantity.

42. According to paragraphs 2.36 to 2.38 of the Audit Report, the DSI Panel had commented that as the participating brands and designers would get good exposure, they should pay their own travel and hotel expenses. However, as it transpired, the travel expenses of the participating brands and designers were met by the HKDC, from funds obtained by auctioning nine of the 10 creative products. The Committee asked the Chief Executive Officer, HKDC:

- about the justifications for not following the advice of the DSI Panel, and whether these had been put up to the DSI Panel for consideration; and
- about the procedure that he had gone through in obtaining approval for departing from the DSI Panel's advice.

43. The **Chief Executive Officer, HKDC** replied that:

- Project 9707 created a win-win situation for both the participating brands and designers, and the Hong Kong design industry. The former could gain good exposure to promote their business/service. On the other hand, the participation of brands and designers in the exhibitions/symposiums in Beijing and Hong Kong in December 2007 was critical to the promotion of Hong Kong's design industry and the development of international frontiers for the design profession;
- the HKDC noted the DSI Panel's view. However, the HKDC considered it justifiable to meet the travel and hotel expenses incurred by staff of the brands and designers, particularly given that the designers had contributed their time and service free of charge, and the brands had made substantial investments in the research, prototyping and manufacturing of the products. Faced with such a dilemma, the HKDC adopted a compromising arrangement whereby the travel and hotel expenses were paid from the auction proceeds, instead of public funds. As no government funding was involved, the ITC had confirmed that it saw no objection to the arrangement. The donors concerned had also reaffirmed their understanding of the specific usage of the funds;
- the HKDC was only informed of the DSI Panel's view after the meeting was over and hence could not give its views to the Panel. As regards procedure, the FAC's approval for the arrangement had been obtained by circulation of paper. As Board meetings were held quarterly, the arrangement could not be put up to the Board for consideration at its meeting at that time. Nevertheless, the Chairman and Vice-chairman of the Board had given consent to the arrangement; and
- in case of similar situation in future, the HKDC would be more prudent and strengthen communication with the Commissioner for Innovation and Technology and the DSI Panel, with a view to reaching a consensus.

44. In his letter of 9 January 2009, the **Chief Executive Officer, HKDC** supplemented that the Board's retrospective approval for paying the travel expenses of the brands' representatives and designers from the auction proceeds had been obtained at the Board meeting on 22 September 2008, when the draft Audit Report was discussed.

45. The Committee further referred to the following problems relating to Project 9707 and the BODW identified in the Audit Report, and asked the HKDC how it would improve its internal control and accounting systems to ensure compliance with set guidelines and requirements:

- three months after Project 9707 was completed, as at 30 June 2008, only three brands and three designers participating in the project had signed a Memorandum of Understanding ("MOU") with the HKDC, which specified the rights and obligations of the parties concerned, contrary to the HKDC's undertaking in its project proposal that it would sign an MOU with all parties concerned;
- there was no documentation to record the basis adopted by the HKDC for shortlisting and selecting the brands and designers to participate in the project; and
- contrary to the DSP funding agreement and funding guidelines, pre-project commencement expenses were charged to the Project 9707 account without the ITC's approval, the expenses incurred for buying tickets to participate in the HKDC Annual Award Gala Dinner were charged to the Project 9707 account, and entertainment expenses were charged to the BODW project accounts.

46. The **Chief Executive Officer, HKDC** responded that:

- all the participating brands and designers of Project 9707 had now signed the MOUs with the HKDC;
- the shortlisting and selection of the brands and designers involved in Project 9707 were steered by the Chairman and Vice-chairman of the Board, in consultation with the design community. The DSI Panel had also been briefed. Owing to time and manpower constraints, the HKDC had focused on marketing and liaison work and neglected the requirement for proper documentation. The HKDC would keep proper records on the shortlisting and selection of participants for large projects in future;
- the expenses involved in the cases mentioned above were all justified, but had been charged to the wrong accounts due to oversight. There were basically two sources of government funding to the HKDC, namely funding provided under the DSI which was used to support Project 9707 and the BODW project, and the \$100 million allocated in May 2007 to support the HKDC's basic operation. The pre-project commencement expenses, expenses for buying tickets for the brand representatives and designers attending the HKDC Annual Award Gala Dinner, and entertainment expenses were regarded as expenditures arising from the HKDC's daily operations, so they should not be charged to the project votes. There was no question of the HKDC spending money which should not be used; and

- the HKDC already had a Corporate Governance Manual providing guidelines on governance and administration matters. However, in view of the problems identified in the Audit Report, he had compiled a more direct and simpler handbook for reference by the HKDC's staff responsible for vetting and approving applications. Moreover, the HKDC had put in place an internal audit mechanism. With the implementation of these measures, it was expected that the HKDC's internal control procedures would be tightened and level of compliance with established rules and regulations would be enhanced.

47. According to paragraph 2.49 of the Audit Report, the DSI Panel had urged the HKDC to develop a long-term financial sustainability plan for the BODW and to reduce its reliance on the GSS for funding the BODW. However, up to August 2008, the HKDC had yet to develop a long-term financial sustainability plan with a timetable for achieving self-sufficiency. The Committee asked about the HKDC's plan to maintain the financial sustainability of the BODW.

48. The **Chief Executive Officer, HKDC** stated at the public hearing and in his letter of 9 January 2009 that:

- as shown in Table 4 of the Audit Report, the project income of the BODW had been increasing over the last few years. However, it was unlikely that the BODW could achieve self-sufficiency at this stage. Experience of overseas countries indicated that substantial government funding was required for similar projects, which involved a lot of educational and promotional work;
- the BODW had contributed to the Hong Kong brand and the HKDC's goal to become the design hub of Asia. The number of attendees and visitors to the conferences, seminars, workshops and exhibitions of the BODW had been on a rising trend, increasing from 30,000 in 2004 to 50,000 in each of 2007 and 2008; and
- as the BODW was now in its seventh year, the HKDC decided to take stock and an external consultant had been appointed to review the positioning and strategy of the BODW. The study included an elaboration of the results and effectiveness of the event, and recommendations on the development of a long-term financial plan. The HKDC aimed to finalise the report in January 2009 and submit it for the Board's consideration in early February 2009.

D. Promotion of design by the HKDC

49. According to paragraphs 3.13 and 3.14 of the Audit Report, the HKDC stated in its business plan and annual budget various initiatives for enhancing the design infrastructure. However, the implementation of these initiatives had met with considerable delays. For instance, the development of the design directory was completed almost four years after the planned completion date. The Committee asked how the HKDC would ensure that its design infrastructure projects would not be further delayed.

50. The **Chief Executive Officer, HKDC** replied that:

- the delay in completing the design directory was due to the unforeseen long time taken to discuss with the design community and business users to formulate the project proposals, and the difficulties encountered in the discussion process. For example, some design associations had expressed concern about duplication of resources as the Hong Kong Trade Development Council had similar directories. The discussion took quite some time to complete. Moreover, time had been wasted in seeking funding support for the project from the DSP, which turned out to be unsuccessful; and
- to ensure that its design infrastructure projects would not be unduly delayed in future, the HKDC had put in place a more comprehensive project control system, which included holding frequent internal project review meetings among staff and involving the Board in reviewing project progress on a quarterly basis.

51. According to paragraphs 3.20 and 3.22 of the Audit Report, the HKDC was required to achieve an income target of 20% for 2008-2009 set by the ITC, and the HKDC's projection in July 2008 showed that it might not be able to meet this target. The Committee asked why the HKDC could not achieve the income target and about the measures that it had taken to boost the income for 2008-2009.

52. The **Chief Executive Officer, HKDC** responded that:

- the HKDC originally estimated that it could meet the income target, but it turned out that the actual income was less than expected because:
 - (a) the summer overseas design and cultural tour for students, which was an income-generating event, was cancelled due to an unexpectedly low response to the HKDC's initial marketing;

- (b) some projects in the original plan were subsequently organised as part of the "Reinventing with Design" conference held in June 2008 under the DSP funding instead; and
 - (c) due to the prevailing economic conditions, businesses were expected to be less generous in sponsorships. For example, the target sponsorship of \$625,000 for holding exhibitions at the InnoCentre was unlikely to be met. Only \$400,000 was raised in a fund-raising activity held recently, which was much less than the original target of \$1million; and
- the HKDC would try to improve the expenditure/revenue ratio by cutting expenditure and increasing revenue. For instance, salary and general expenses had been reduced by \$2.55 million in 2008. Additional revenue had been generated by holding more activities, such as courses and seminars on design and branding for senior civil servants. Moreover, a large-scale exhibition had been held in Shanghai, generating an income of \$1.36 million. With these efforts, it was estimated that the HKDC would be able to achieve an expenditure/revenue ratio of 15%, though not 20%.

53. Paragraphs 3.24 to 3.27 of the Audit Report revealed that the amount of unspent balance of the funding approved under the InnoCentre Programme, as reported by the HKDC in July 2007, had been understated by about \$4.5 million. The Committee noted that the funding allocated to the HKDC under the InnoCentre Programme was disbursed by instalments, and any unspent amount would be deducted from the funding for the following period. The Committee therefore enquired whether the understatement of \$4.5 million might lead to an over-provision of funding to the HKDC.

54. In his letter of 2 January 2009 in *Appendix 21*, the **Director of Audit** stated that:

- Audit informed the ITC of the understatement of unspent balance in May 2008. In September 2008, the ITC informed Audit that, owing to heavy work commitment around March 2008 and in trying to meet the payment deadline at close of financial year, the third quarterly disbursement was made to the HKDC without further updating the unspent balance according to the audited accounts. After confirmation with the HKDC, the updating and offsetting was made when considering the fourth disbursement in June 2008. The updating and offsetting was thus delayed by a quarter; and
- as the understatement of unspent balance was subsequently rectified in June 2008, it did not lead to an over-provision of funding to the HKDC. Nonetheless, Audit considered that the ITC should ensure that the unspent balance was properly reported by recipients of DSI funding.

55. In his letter of 9 January 2009, the **Chief Executive Officer, HKDC** stated that the amount of \$2.5 million reported by the HKDC to the ITC in July 2007 (subsequently adjusted to \$2 million in December 2007) represented the unspent balance for the three-month period from 1 April to 30 June 2007. The HKDC did report the cumulative unspent balance of \$6.5 million under the InnoCentre Programme through submission of the audited accounts to the ITC in December 2007. As the HKDC's accounts were audited by professional accountants, he did not see the possibility of the HKDC benefitting from over-provision of funds from the ITC.

E. Administration of the Design Incubation Programme ("DIP")

56. The Committee noted that according to the Memorandum of Administrative Arrangements signed between the Hong Kong Science and Technology Parks Corporation ("HKSTPC") and the ITC for the DIP ("DIP-MAA"), the HKSTPC should offer a one-year mentorship programme, as part of the technical and management assistance to be provided to incubatees. Paragraph 5.12 of the Audit Report revealed that the participation rate of the mentorship programme was low. The Committee asked why the mentorship programme was not popular among the incubatees and about the remedial measures taken.

57. The Committee also asked about the actions taken by the HKSTPC in response to the following Audit observations:

- no records were kept to show that due diligence visits had been carried out by the HKSTPC to verify information provided by DIP applicants, as required by the HKSTPC's DIP guidelines (paragraph 5.19 of the Audit Report refers); and
- despite the Design Admission Panel's decision that a marking sheet should be used to facilitate it in assessing the qualitative aspects of DIP applicants, the marking sheet had not been used (paragraph 5.20 of the Audit Report refers).

58. **Mr E Anthony TAN, Chief Executive Officer, HKSTPC**, replied that:

- participation in the mentorship programme was on a voluntary basis. The HKSTPC conducted a survey in August 2008 to investigate the reasons for the low participation rate. It was found that the incubatees did not join the programme mainly because they were not willing to share their creative and innovative ideas with other people, particularly those from the design trade, including the mentors;

- to improve the situation, the HKSTPC would, with agreement from participating incubatees and mentors, publicise success cases of mentorship to non-participating incubatees, so as to encourage their participation in the mentorship programme;
- the incubatees were design start-up companies which often did not have an office for visit by the HKSTPC staff, e.g. they might work at home and apply to join the DIP. Hence, since November 2007, the responsible HKSTPC staff interviewed DIP applicants at the InnoCentre to verify the information provided in their applications. The interview records were also submitted to the Design Admission Panel;
- the HKSTPC would revise the due diligence evaluation report format to capture the name of interviewers/interviewees and the date/time/venue of interview; and
- the idea of using a marking sheet to facilitate assessment of DIP applicants was raised by the chairman of the Design Admission Panel at a meeting, but the marking sheet was not used subsequently. Notwithstanding this, the Design Admission Panel did assess the applicants according to each of the criteria set out in the DIP-MAA. He would seek the Design Admission Panel's formal decision as to the applicability of the original proposed quantitative marking sheet for assessing DIP applications.

59. The Committee noted the response of the Chief Executive Officer, HKSTPC in paragraph 5.39(a) of the Audit Report that the HKSTPC would request the Design Advisory Panel to give guidelines to DIP applicants to help them set realistic quantitative milestone targets. The Committee asked about the progress made and whether the HKSTPC had encountered any difficulty in drawing up the guidelines.

60. The **Chief Executive Officer, HKSTPC** responded that it was indeed difficult to set quantitative targets for design companies. However, the HKSTPC agreed that it was desirable to set measurable targets as far as possible to enable progress assessment. As the Design Advisory Panel comprised designers, industrialists and academics of various design disciplines, it could give expert advice on the setting of realistic quantitative milestone targets by DIP applicants.

61. In view of the various problems in the administration of the DIP as revealed by Audit, the **Chief Executive Officer, HKSTPC** said that the HKSTPC did not have experience in the design industry, and it needed to accumulate more experience in managing the DIP which was a new initiative launched in 2006. The HKSTPC planned to improve the operation of the DIP by using the funding for the programme more flexibly to

assist the incubatees, keeping proper records and documentation in evaluating applications and assessing the performance of incubatees, and issuing guidelines to help applicants set milestone targets which were more measurable.

F. Overseas practices in the promotion of design

62. As reported in paragraph 6.3 of the Audit Report, many countries which were renowned for their design capability had formulated national design policies and programmes to promote design. For example, the UK Department for Innovation, Universities and Skills published a White Paper entitled "Innovation Nation" in March 2008, listing out details of actions that the UK Government would carry out to promote design.

63. Noting that it was the Government's policy to strengthen the support for design and innovation and to better harness the economic potentials of design, and that the Government had devoted a large amount of money to promoting design in Hong Kong over the past five years (i.e. 250 million for launching the DSI in 2004 and another \$100 million to the HKDC in 2007 to enhance its roles in promoting design), the Committee asked the Secretary for Commerce and Economic Development how the Administration would engage the public at large in its policy objective.

64. The **Secretary for Commerce and Economic Development** responded that:

- as the DSI had been implemented for almost five years, it was opportune to review its achievements. For example, the BODW had been a very successful programme for providing training and commercial opportunities to the design and creative industries. It had become the largest annual design event in Asia and one of the leading design events in the world;
- currently, the different aspects of the creative industries were handled by different government departments, e.g. the Television and Entertainment Licensing Authority, the Trade and Industry Department and the ITC, giving rise to the impression that the government policy on creative industries was not clear and coherent. She agreed that a consolidated policy paper should be issued to set out the Government's vision and policy for promoting the development of creative industries, so as to engage various stakeholders and the public in its policy direction;
- the Chief Executive announced in his 2008-2009 Policy Address that to promote the development of creative industries, the Commerce and Economic Development Bureau ("CEDB") would set up a dedicated Creative Industry Office with integrated and realigned resources from related departments. The new Office would co-ordinate the work of different departments and

work closely with the trades to boost the development of creative industries. It would also consider providing more effective support for Hong Kong's creative industries through integration of resources; and

- to implement the above policy initiative, the CEDB should work together with and listen to the views of the relevant trades and industries. The CEDB had commenced work in this respect and was consulting the relevant representatives from the industries on how to take forward the policy initiative. The CEDB aimed to set up the Creative Industry Office on 1 April 2009 and would, at the same time, formulate strategic measures for implementing the government policy on promoting the development of creative industries.

65. The Committee further asked about the progress made in developing suitable targets and methods/indicators for measuring the performance and effectiveness of the DSI. The **Secretary for Commerce and Economic Development** said that the Administration would study the experience of overseas countries in evaluating and reporting the performance of their initiatives to promote design, with a view to developing more suitable outcome targets and indicators on design promotion in Hong Kong.

G. Conclusions and recommendations

66. The Committee:

Corporate governance and administration of the Hong Kong Design Centre ("HKDC")

- regrets that the HKDC is yet another government-funded organisation found to have problems and inadequacies in corporate governance that has become the subject of a report by the Director of Audit and has required examination by the Committee in recent years, the others being the English Schools Foundation, Hong Kong Applied Science and Technology Research Institute Company Limited, Hong Kong Tourism Board and Society for the Aid and Rehabilitation of Drug Abusers;
- expresses serious concern and finds it unacceptable that the Board of Directors ("Board"), which is responsible for directing the development and operations of the HKDC and monitoring the performance of the HKDC's management, has not properly discharged its responsibilities, as reflected by the following:

- (a) the attendance rates of some directors, including the Deputy Secretary for Home Affairs as one of the two government directors, at the Board/Committee meetings were low;
 - (b) at three (60%) of the five Finance and Administration Committee ("FAC") meetings held between March 2007 and June 2008, the quorum requirement was not met;
 - (c) the HKDC has adopted a "one-tier reporting system" for its directors to declare and report conflicts of interest, despite the fact that it meets, to a large extent, the criteria for adopting a "two-tier reporting system" set out in the guideline issued by the Home Affairs Bureau;
 - (d) there were weaknesses in the HKDC's internal control and accounting systems, details of which are given in the part on "Management of projects funded by the Design Support Programme ("DSP")" below; and
 - (e) the HKDC has failed to comply with the requirements and guidelines on governance and administration matters set out in its Corporate Governance Manual, for example:
 - (i) for the procurement of goods and services, the guidelines on the number of quotations required and the approval limits stipulated in the Corporate Governance Manual were not followed in some cases;
 - (ii) air tickets were purchased before application for approval was made or written approval was obtained in a number of cases; and
 - (iii) approval for reimbursing the travel expenses incurred by a Board member was given by the Chairman instead of the Board as required by the Corporate Governance Manual in a number of cases;
- expresses serious concern and finds it unacceptable that whilst the two government directors (i.e. the Commissioner for Innovation and Technology and the Deputy Secretary for Home Affairs) on the Board may not carry a heavier weight than the other directors, they have together not been able to discharge the added dimension of their responsibilities as the guardian of the public interest to ensure proper utilisation of the public funds allocated to the HKDC, in so much that problems and inadequacies have been found in the HKDC's corporate governance;

- notes that the Home Affairs Bureau intends to send a representative to sit on the Board in the capacity of an observer instead of a director, and expresses concern as to how the single government director left on the Board can effectively safeguard the public interest in dealing with any problems and inadequacies in the HKDC's corporate governance;
- acknowledges that:
 - (a) the HKDC has put in place an internal audit mechanism to ensure compliance with the requirements and guidelines in the Corporate Governance Manual, and the Government has appointed a professional accountant to the Board who serves as the Chairman of the FAC and will oversee the mechanism;
 - (b) the Board has decided to adopt the two-tier reporting system for declaration of interests by its directors;
 - (c) the Secretary for Commerce and Economic Development has accepted the audit recommendation in paragraph 4.12 of the Director of Audit's Report ("Audit Report"); and
 - (d) the Chief Executive Officer, HKDC has accepted the audit recommendations in paragraphs 4.13, 4.21, 4.26 and 4.34 of the Audit Report;
- urges the HKDC to consider publishing the attendance records of Board/Committee meetings in its annual reports;
- in view of the repeated occurrence of corporate governance problems in government-funded organisations, urges the Administration to attach the utmost importance to ensuring sound corporate governance in such organisations, educate their staff about the importance of achieving sound corporate governance and accountability in using public funds, and consider taking measures, including but not limited to the following, to strengthen their corporate governance by system design:
 - (a) formulating a code of best practice on corporate governance for government-funded organisations for reference by the organisations, and requiring the organisations to produce a report on compliance with the code and publish the same in their annual reports to enhance accountability;

- (b) in selecting individuals for appointment to the governing bodies of government-funded organisations, appointing persons with knowledge and experience in corporate governance who could afford the time to contribute their service;
- (c) providing briefings on corporate governance requirements to members of the governing bodies of government-funded organisations; and
- (d) for small-sized government-funded organisations like the HKDC, which may not have sufficient resources to hire an internal auditor to oversee compliance issues, arranging for the secondment of a government treasury accountant to such organisations to help train up their staff in corporate governance matters, or extending the scope of service provided by the external accountants hired by the organisations to cover compliance matters;

Management of projects funded by the DSP

- expresses great dissatisfaction and disappointment that:
 - (a) the total number of projects which benefited from the DSP (i.e. 200 as at December 2008) was very much lower than that expected (i.e. 700 by June 2009); and
 - (b) the Commissioner for Innovation and Technology, being the Controlling Officer of the DesignSmart Initiative ("DSI") and responsible for administering the DSP, has failed to:
 - (i) strictly enforce the DSP funding guidelines and the DSP funding agreement, as follows:
 - in some cases, the requirements stipulated in the guidelines on conflicts of interest issued by the Innovation and Technology Commission ("ITC") to members of the DSI Assessment Panel were not complied with; and
 - despite the requirement in the DSP funding guidelines issued by the ITC, there were delays in the submission of project completion reports by fund recipients of the DSP; and
 - (ii) review the operation of the DSP periodically as undertaken by the Administration in seeking funding approval for the DSI in June 2004. Of the four DSP funding schemes, the ITC had only completed reviewing the Design Research Scheme and the Design-Business Collaboration Scheme by June 2008 while no

review had been conducted on the Professional Continuing Education Scheme ("PCES") and the General Support Scheme ("GSS"). The failure to review the funding schemes in a timely manner might have led to delays in identifying any areas for improvement that could help optimise the utilisation of some of the funding schemes;

- expresses serious dismay and finds it unacceptable that the HKDC, in managing Project 9707 and the Business of Design Week ("BODW") project, has failed to comply with the DSI Assessment Panel's advice, the DSP funding guidelines and the DSP funding agreement, and to see to the good and proper management of the projects, as follows:
 - (a) there was no documentation to record the basis adopted by the HKDC for shortlisting and selecting the brands and designers to participate in Project 9707;
 - (b) three months after Project 9707 was completed, as at 30 June 2008, only three brands and three designers participating in the project had signed a Memorandum of Understanding ("MOU") with the HKDC, contrary to the HKDC's undertaking in its project proposal that it would sign an MOU with all parties concerned;
 - (c) despite the advice given by the DSI Assessment Panel that brands and designers participating in Project 9707 should pay their own travel and hotel expenses, such expenses were met by the HKDC;
 - (d) notwithstanding the advice given by the DSI Assessment Panel that the HKDC should reduce its reliance on the GSS for funding the BODW project, the HKDC did not develop a long-term financial sustainability plan for the project; and
 - (e) the following errors have occurred in connection with the projects:
 - (i) contrary to the DSP funding agreement, pre-project commencement expenses of about \$173,000 were charged to the Project 9707 account without the ITC's approval;
 - (ii) a sum of \$75,000 incurred for buying tickets to participate in the HKDC Annual Award Gala Dinner was wrongly charged to the Project 9707 account, contrary to the DSP funding guidelines that DSP funding should not be used to meet entertainment expenses; and

- (iii) contrary to the DSP funding guidelines, entertainment expenses were wrongly charged to the BODW project accounts;
- acknowledges that:
- (a) the ITC has introduced the two-tier reporting system for declaration of interests by all DSI Assessment Panel members with effect from 1 January 2009;
 - (b) the DSI Assessment Panel has agreed that the ITC would send a warning letter to a fund recipient of the Design-Business Collaboration Scheme who has not submitted the project completion report over three months after the due date;
 - (c) the ITC will review the PCES and the GSS from the first half of 2009 and, after completing these reviews, conduct an overarching review of the DSP;
 - (d) all the participating brands and designers of Project 9707 have signed the MOUs with the HKDC;
 - (e) the HKDC has appointed a consultant to review the positioning and strategy of the BODW, including making recommendations on the development of a long-term financial plan. The consultant's report would be considered by the Board in early February 2009;
 - (f) the Commissioner for Innovation and Technology has accepted the audit recommendations in paragraphs 2.13, 2.19 and 2.24 of the Audit Report; and
 - (g) the Chief Executive Officer, HKDC has accepted the audit recommendations in paragraphs 2.46 and 2.62 of the Audit Report;
- urges that:
- (a) the Commissioner for Innovation and Technology should:
 - (i) unless for good and justifiable reasons to be fully documented, strictly enforce the requirements in the DSP funding guidelines and the DSP funding agreement; and
 - (ii) review the PCES and the GSS and then the DSP as a whole without delay, with a view to identifying areas for improvement to help optimise the utilisation of the funding schemes; and

- (b) the Chief Executive Officer, HKDC should:
 - (i) unless for good and justifiable reasons to be fully documented, comply with the DSI Assessment Panel's advice, the DSP funding guidelines and the DSP funding agreement, and ensure the good and proper management of the projects funded by the DSP; and
 - (ii) take measures to improve the HKDC's internal control and accounting systems;

Promotion of design by the HKDC

- expresses great dissatisfaction and disappointment that:
 - (a) the implementation of a number of initiatives stated in the HKDC's business plan and annual budget for enhancing the design infrastructure had met with considerable delays;
 - (b) it is unlikely the HKDC will meet the income target of 20% for 2008-2009 set by the ITC; and
 - (c) the amount of unspent balance of the funding approved under the InnoCentre Programme reported by the HKDC had been understated by about \$4.5 million;
- acknowledges that:
 - (a) the ITC has accepted in principle that sponsorship-in-kind could also be taken into account in assessing the expenditure/revenue ratio of the HKDC;
 - (b) in June 2008, the ITC deducted \$4.5 million from the disbursement to the HKDC for 2008-2009 and, in future, the ITC will verify reported unspent balance against other independent sources such as bank balance statements and audited accounts at each quarterly disbursement;
 - (c) the Commissioner for Innovation and Technology has accepted the audit recommendations in paragraphs 3.16 and 3.29 of the Audit Report; and
 - (d) the Chief Executive Officer, HKDC has accepted the audit recommendations in paragraphs 3.11, 3.17, and 3.30 of the Audit Report;
- urges the Commissioner for Innovation and Technology and the Chief Executive Officer, HKDC to expeditiously implement the above audit recommendations;

Administration of the Design Incubation Programme ("DIP")

- expresses serious dismay and finds it unacceptable that:
 - (a) in some cases, disbursement of financial assistance was not made in accordance with the Memorandum of Administrative Arrangements for the DIP and the guidelines issued by the Hong Kong Science and Technology Parks Corporation ("HKSTPC"); and
 - (b) supporting documents submitted by incubatees in making claims for reimbursement of expenses under the DIP were often inadequate;
- expresses dissatisfaction that:
 - (a) no records were kept to show that due diligence visits had been carried out by the HKSTPC to verify information provided by DIP applicants;
 - (b) there was no documentation showing that the HKSTPC had submitted supplementary information to the Design Admission Panel to clarify its concerns in conditional approval cases;
 - (c) the milestone targets set by incubatees in their applications were often non-quantitative, which did not facilitate progress assessment or benchmarking; and
 - (d) documentation of milestone assessments was not always kept;
- acknowledges that:
 - (a) the HKSTPC will:
 - (i) revise the due diligence evaluation report format to capture the name of interviewers/interviewees and the date/time/venue of interview; and
 - (ii) modify the milestone assessment form to enable the assessor to fill in justifications for the judgments made, and to include a checklist on supporting documents to be reviewed; and
 - (b) the Chief Executive Officer, HKSTPC has accepted the audit recommendations in paragraphs 5.14, 5.25, 5.38 and 5.42 of the Audit Report;

- urges the Chief Executive Officer, HKSTPC to ensure compliance with the Memorandum of Administrative Arrangements for the DIP and the HKSTPC's guidelines, and expeditiously implement the above audit recommendations;

Overseas practices in the promotion of design

- notes that the Government has devoted a large amount of money to promoting design in Hong Kong over the past five years, i.e. 250 million for launching the DSI in June 2004 and another \$100 million to the HKDC in May 2007 to enhance its roles in promoting design;
- expresses serious concern that there is a lack of outcome targets/indicators to evaluate the effectiveness of the Government's initiatives to promote design in Hong Kong;
- acknowledges that:
 - (a) the Commerce and Economic Development Bureau aims to set up a dedicated Creative Industry Office with integrated and realigned resources from related departments on 1 April 2009. The Office will co-ordinate the work of different departments and work closely with the trades to boost the development of creative industries; and
 - (b) the Commissioner for Innovation and Technology has accepted the audit recommendations in paragraph 6.11 of the Audit Report;
- strongly urges the Secretary for Commerce and Economic Development to expeditiously issue a policy paper to set out the Government's vision and policy for promoting the development of creative industries, including design, and engage various stakeholders and the public in its policy direction; and

Follow-up actions

- wishes to be kept informed of:
 - (a) the HKDC's decision regarding publishing the attendance records of Board/Committee meetings in its annual reports;
 - (b) the Administration's decision regarding the measures proposed by the Committee to strengthen corporate governance in government-funded organisations by system design;
 - (c) the progress of the ITC's reviews of the PCES, the GSS and the DSP;

- (d) the measures taken by the Chief Executive Officer, HKDC to improve the HKDC's internal control and accounting systems;
- (e) the progress made by the Administration in issuing a policy paper on the development of creative industries, including design; and
- (f) the progress made in implementing the various audit recommendations.