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19 May 2010

Clerk, Public Accounts Committee
Legislative Council Building
8 Jackson Road
Central
(Attn: Ms Macy NG)

Dear Ms NG,

**The Director of Audit's Report on the
results of value for money audits (Report No. 54)
Hong Kong Chinese Orchestra Limited (Chapter 6)**

Thank you for your letter of 13 May 2010. The requested information is set out below.

- (a) When the Hong Kong Chinese Orchestra (HKCO) was corporatised in 2001-02, the Leisure and Cultural Services Department (LCSD) entered into a Funding and Services Agreement (FSA) with HKCO annually as the latter's subventing body. The Home Affairs Bureau (HAB) has then entered into an FSA with HKCO annually following the transfer of funding responsibility of HKCO from LCSD to HAB since 1 April 2007.

- (b) A chronology setting out the actions taken in relation to the scope of an auditor's opinion on an audited financial report is attached at the Annex.

As explained in the chronology, the Financial Services and the Treasury Bureau advised HAB in 2007 that "the detailed requirements and presentation of the annual financial report to be submitted might be determined by the Controlling Officer taking into account any specific requirements, and *where necessary*, in consultation with the Director of Accounting Services (DAS)". DAS was not consulted subsequently because HAB was satisfied that the audited financial reports (including detailed financial statements) submitted by the subvented performing arts groups had duly fulfilled the purpose of Annex C of the FSA of ensuring proper management and control of government funding as it was not our intention to seek a confirmation from the auditor on provisions of the FSA which touches on non-financial matters.

Yours sincerely,



(Gilford LAW)

for Secretary for Home Affairs

- cc. Executive Director, Hong Kong Chinese Orchestra Limited
Secretary for Financial Services and the Treasury
Director of Audit

Requirement on an Auditor's Opinion
Chronology of Events

No.	Date	Events / Development
1.	March 2001	<ul style="list-style-type: none"> • The Leisure and Cultural Services Department (LCSD) entered into a Funding and Services Agreement (FSA) with the Hong Kong Chinese Orchestra (HKCO) to prepare for the latter's corporatisation in April 2001. There were no requirements in the FSA for an auditor to provide an opinion on the audited financial reports.
2.	September 2004	<ul style="list-style-type: none"> • The Financial Services and the Treasury Bureau (FSTB) issued the Financial Circular No. 9/2004 "Guidelines on the Managements and Control of Government Funding for Subvented Organisations" (the Circular).
3.	April 2005	<ul style="list-style-type: none"> • With reference to the Circular, LCSD included a requirement for an auditor's opinion on the audited financial reports, among others, in the Annex C of the FSA for 2005-06¹ with its four subvented performing arts groups, including HKCO. • The audit requirement reads "on the annual financial report of the activities being audited, the auditors' report shall contain an opinion as to whether the company has complied with, in all material respects, the requirements as may be set by the Government and all the terms and conditions of the FSA and other relevant documents as may be specified by the Government." (hereafter referred to as "requirement on an auditor's opinion on the financial report").

¹ The same Annex C was incorporated in LCSD's FSA for 2006-07 with its subvented performing arts groups.

No.	Date	Events / Development
4.	November 2005	<ul style="list-style-type: none"> The Assistant Director (Finance) of LCSD informed the Deputy Director (Culture) that the 2004-05 audited financial statements of HKCO (and other subvented performing arts groups) did not contain an auditor's opinion on the financial report of the subvented activities. In response, the Assistant Director (Performing Arts) explained that when the 2004-05 FSA was signed in early 2004, the Circular was not yet issued. Upon the issuance of the Circular in September 2004, the requirement on an auditor's opinion on the financial report was included into the FSAs for 2005-06 and full compliance with the requirement would be closely monitored.
5.	April 2007	<ul style="list-style-type: none"> Following up on the Recommendation Report of the Committee on Performing Arts, the Home Affairs Bureau (HAB) took up the funding responsibility for the then ten major performing arts groups², including HKCO from LCSD from 2007-08. The arrangement was meant to be transitional, pending results of a funding review of the subvented performing arts sector. Inherited from LCSD's FSAs with its performing arts groups, HAB adopted the same Annex C for its FSAs for 2007-08³ for the major performing arts groups, including the requirement on an auditor's opinion on the financial report. Before signing the FSAs for 2007-08, HAB received an enquiry from one of the groups formerly funded by the HKADC concerning Annex C. The group provided HAB with a copy of its Report of the

² The groups included six from the Hong Kong Arts Development Council (HKADC).

³ The same Annex C was incorporated in HAB's FSAs for the major performing arts groups for 2008-09 and 2009-10.

No.	Date	Events / Development
		<p>Directors and Audited Financial Statements for 2005-06 (without an auditor's opinion on the financial report) for HAB's confirmation on whether the Report had already fulfilled all the requirements stipulated at Annex C of the FSA for 2007-08.</p>
6.	4 April 2007	<ul style="list-style-type: none"> HAB wrote to FSTB with the above group's Report and sought the latter's confirmation on whether the Report had already fulfilled all the requirements stipulated in paragraph 10.1 to 10.6 of the Circular concerning submission of audited accounts.
7.	15 May 2007	<ul style="list-style-type: none"> FSTB advised that "in accordance with paragraph 10.3 of the [Circular], the detailed requirements and presentation of the annual financial report to be submitted might be determined by the Controlling Officer taking into account any specific requirements, and where necessary, in consultation with the Director of Accounting Services". On the basis of FSTB's advice, HAB considered that the audited financial reports (including detailed financial statements) submitted by the above group had duly fulfilled the purpose of Annex C of the FSA of ensuring proper management and control of government funding. As such, HAB did not require the groups to provide further information, i.e. an auditor's opinion on the financial report.
8.	February 2010	<ul style="list-style-type: none"> At HAB's meeting with the major performing arts groups on 9 February, HKCO expressed its concern over the impracticability of engaging an auditor to carry out compliance audit on all the terms and conditions of the FSA as stipulated in Annex C of the FSA. On 12 February, the major performing arts groups issued a joint letter to HAB which set out, among others, the concern raised by HKCO.

No.	Date	Events / Development
9.	16 March 2010	<ul style="list-style-type: none"> HAB wrote to FSTB to seek its advice on whether and how the requirement on an auditor's opinion on the financial report could be better framed to reflect the purpose of ensuring proper management and control of government funding instead of seeking an audit on every single details of the FSA which touches on non-financial matters.
10.	25 March 2010	<ul style="list-style-type: none"> FSTB advised HAB that, among other things, the relevant section of the Circular, from which the requirement in Annex C of the FSA originates, is mainly focused on the monitoring of financial matters of the subvented organisations. The Controlling Officer has the flexibility to require subvention organisations under his purview to define the objectives and scope of auditors' duties.
11.	31 March 2010	<ul style="list-style-type: none"> Having regard to the advice from FSTB, HAB revised Annex C in the FSA for 2010-11 to reflect better the intention of the requirement on an auditor's opinion on the financial report to ensure proper management and control of government funding.
12.	21 April 2010	<ul style="list-style-type: none"> On the day when the Report No. 54 of the Director of Audit – Chapter 6 Hong Kong Chinese Orchestra Limited was made public, HAB forwarded a copy of FSTB's advice concerning the requirement on an auditor's opinion on the financial report to the Treasury for information.