

A. Introduction

The Audit Commission ("Audit") conducted a review of the Hong Kong Chinese Orchestra Limited ("HKCO") with focus on its governance and management issues, covering the following areas:

- corporate governance;
- core activities;
- human resources management; and
- other administrative issues.

2. The Committee noted that the Audit review did not in any way reflect on the artistic performance of the HKCO's work.

3. The Committee held two public hearings on 11 and 27 May 2010 respectively to receive evidence on the findings and observations of the Director of Audit's Report ("Audit Report").

4. **Hon Paul CHAN Mo-po** declared that he had been a Council member of the HKCO in the past but not at present. He was currently a sponsor of the HKCO. As such, he had received complimentary tickets from the HKCO before.

5. **Hon Starry LEE Wai-king** declared that she and Dr Carlye TSUI, Council Chairman of the HKCO, were both members of the Democratic Alliance for the Betterment and Progress of Hong Kong.

6. **Mr TSANG Tak-sing, Secretary for Home Affairs, and Dr Carlye TSUI, Council Chairman of the HKCO,** respectively made an opening statement at the public hearing on 11 May 2010. The full texts of their statements are in *Appendices 11 and 12* respectively.

B. Criteria for evaluating subvented performing arts groups

Audit requirements under the Funding and Services Agreement ("FSA")

7. According to paragraph 1.6 of the Audit Report, to ensure proper administration of the HKCO and that public money is used properly and cost-effectively, the Home Affairs Bureau ("HAB") enters into an FSA with the HKCO on an annual basis.

8. Paragraphs 2.8 to 2.10 of the Audit Report revealed that since 2005-2006, for each financial year, the HKCO was required under the FSA to submit to the Government an audited financial report containing an audit opinion as to whether the HKCO had complied with, in all material respects, the requirements set by the Government (including the terms and conditions of the FSA). However, for the four years from 2005-2006 to 2008-2009, the auditors' reports submitted by the HKCO did not contain such an audit opinion. Although the Leisure and Cultural Services Department ("LCSD") and the HAB were aware of the HKCO's non-compliance with the audit requirement stipulated in the FSA, they had not taken positive action to address the problem.

9. The Committee referred to clause 4 of the FSA for 2009-2010 (in *Appendix 13*) and noted that some provisions related to the HKCO's artistic mission, e.g. clause 4(a) on providing artistic leadership in the local Chinese music community, and clause 4(c) on establishing regional and international reputation for the HKCO. It appeared to the Committee that they were non-financial matters and practically not auditable. However, under the FSA, the HKCO's auditor was required to express an opinion on whether **all** the terms and conditions of the FSA, including those relating to non-financial matters, had been complied with.

10. Against the above background, the Committee asked:

- whether the HKCO had discussed with its auditor how to carry out audits on the matters set out in clause 4 of the FSA;
- why the HAB had not taken positive action to address the problem of non-compliance in the past, and what remedial measures the HAB had taken/would take after the matter was raised by Audit; and
- why the audit requirements under the FSA included non-financial matters.

11. The **Council Chairman of the HKCO** responded that the HKCO noted the relevant audit requirement in the FSA. However, it was the HKCO's understanding in the past that an audit opinion on subvented activities could be included or not included in the audited financial reports. Following Audit's review, the HKCO had discussed the matter with the HAB. The audit requirement was amended and incorporated into the FSA for 2010-2011. The HKCO would comply with the requirements of the FSA.

12. The **Secretary for Home Affairs** said that:

- the requirement for the submission of audited annual financial statements and audited annual financial reports (as set out in Annex C of the FSAs) was not only applicable to the HKCO but also other major subvented performing arts groups. The performing arts groups all faced similar problem as the HKCO because the FSAs required the auditors engaged by them to give confirmation that the arts groups had complied with the provisions of the FSAs in all aspects, including their artistic work; and
- some performing arts groups had reflected to the HAB that the auditors engaged by them had had difficulties in auditing non-financial matters. In view of Audit's concern, the HAB had recently consulted the Financial Services and the Treasury Bureau ("FSTB") and obtained its consent to require the auditors to express an opinion only on those provisions in the FSAs that were related to financial matters, and not artistic matters. The revised audit requirement was hence incorporated into the 2010-2011 FSA with the HKCO. The other performing arts groups would also require their auditors to carry out audits according to the same principle.

13. **Mr Gilford LAW, Principal Assistant Secretary for Home Affairs (Culture)**, supplemented that:

- under clause 5(d)(ii) of the FSA, the HKCO was required to provide to the Government, within six months after the end of a financial year, audited annual financial statements and an annual financial report of the company in accordance with the requirements set out in Annex C of the FSA;
- the HKCO, being a limited liability company, was required by law to prepare detailed annual financial statements of the company. It also submitted the audited annual financial statements to the Government, thus fulfilling the first requirement in clause 5(d)(ii) of the FSA. On the other hand, Annex C of the FSA (before 2010-2011) required the auditors' report accompanying the annual financial report to contain an opinion as to whether the company had complied with, in all material respects, the requirements as might be set by the Government and "all the terms and conditions of the FSA" and other relevant documents as might be specified by the Government. As Annex C did not specify what the terms and conditions were, they could be taken to mean all the provisions in the FSA, including those that related to artistic achievement and artistic work;
- given that some performing arts groups had raised concern about the practicability 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, the HAB sought the advice of the FSTB in April 2007. As mentioned in

paragraph 2.10(b) of the Audit Report, the FSTB advised 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"); and

- taking into account the FSTB's advice and because the HAB agreed that it was difficult to require auditors to carry out compliance audit on non-financial matters, the HAB had not required the performing arts groups to provide an auditor's opinion on their annual financial reports. However, this was dealt with as a matter of understanding between the performing arts groups and the HAB while the text of the FSA was not amended at that time.

14. The Committee queried:

- when the FSA came into existence;
- why the HAB had not found it necessary to amend the text of the FSA but had relied on the understanding with the performing arts groups, until the matter was raised by Audit;
- why the HAB had not consulted the DAS on the problem of non-compliance with the relevant audit requirement in the FSA, despite the FSTB's suggestion in 2007; and
- whether the HAB considered the performing arts groups' non-compliance with the FSA unimportant.

15. The **Principal Assistant Secretary for Home Affairs (Culture)** said at the public hearing and the **Secretary for Home Affairs** replied in his letter of 19 May 2010 (in *Appendix 14*) that:

- when the HKCO was corporatised in 2001-2002, the LCSD entered into an FSA with the HKCO annually as the latter's funding body. Since taking over the funding responsibility for the then 10 major performing arts groups, including the HKCO, from the LCSD in 2007-2008, the HAB inherited the LCSD's FSAs with its performing arts groups, and adopted the same Annex C for its FSAs for 2007-2008 with the major performing arts groups. This included the requirement on an auditor's opinion on the financial report. The same Annex C was incorporated into the HAB's FSAs with the major performing arts groups for 2008-2009 and 2009-2010;

- the HAB had not consulted the DAS in 2007 because, on the basis of the FSTB's advice, it 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 the HAB's intention to seek a confirmation from the auditor on provisions of the FSA which touched on non-financial matters; and
- the HAB had not amended the text of the FSA at that time because the transfer of the funding responsibility for major performing arts groups from the LCSD to the HAB from 2007-2008, pursuant to the recommendations in the report of the Committee on Performing Arts, was meant to be a transitional arrangement, pending the results of a funding review of the subvented performing arts sector. Hence, the HAB had dealt with the matter by adopting an option which required fewer changes.

16. The Committee asked about the actions taken by the HAB to address Audit's concern after the matter had been raised in the Audit Report. The Committee further requested a chronology of the events showing the actions taken by the LCSD/HAB in relation to the scope of an auditor's opinion on an audited financial report. The **Secretary for Home Affairs** provided the chronology in his letter of 19 May 2010. He also stated that:

- on 16 March 2010, the HAB wrote to the 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 touched on non-financial matters;
- on 25 March 2010, the FSTB advised the HAB that, among other things, the relevant section of Financial Circular No. 9/2004 "Guidelines on the Management and Control of Government Funding for Subvented Organisations", from which the requirement in Annex C of the FSA originated, mainly focused on the monitoring of financial matters of the subvented organisations. The Controlling Officer had the flexibility to require subvention organisations under his purview to define the objectives and scope of auditors' duties;
- on 31 March 2010, having regard to the advice from the FSTB, the HAB revised Annex C in the FSA for 2010-2011 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; and

- on 21 April 2010 when the Audit Report - Chapter 6 on the HKCO was made public, the HAB forwarded a copy of the FSTB's advice concerning the requirement on an auditor's opinion on the financial report to the Treasury for information.

17. Given that the HAB had continued to allocate government subvention to the HKCO for the years from 2005-2006 to 2008-2009 without taking actions to address the problem of non-compliance with the FSAs or improve the audit requirements in the FSAs, the Committee questioned whether the HAB had not performed its monitoring role with due diligence and had allocated the regular subventions to the HKCO as a matter of routine.

18. The **Secretary for Home Affairs** responded that:

- the Government provided funding to the major performing arts groups in Hong Kong through the HAB. The HAB entered into an annual FSA with each of the arts groups, including the HKCO, and monitored their performance in the context of the FSA. As a comprehensive funding review of the subvented performing arts sector would be conducted, the HAB adopted the FSA which was modelled on the Government's general agreements for subvented organisations and not tailor-made for performing arts groups;
- it was the HAB's objective to ensure that the performing arts groups had made proper use of public money in accordance with the principle of prudence while at the same time had enough room for development. On the whole, the HAB was satisfied that such objective had been achieved. Although there were different interpretations of the requirement on an auditor's opinion on the financial report, the HAB did not consider that its funding support to the HKCO should be affected; and
- having regard to Audit's comments, the HAB considered that there was room for improvement and hence amended the text of the FSA to resolve the problem.

19. In his letter of 8 June 2010 in *Appendix 15*, the **Secretary for Home Affairs** further informed the Committee that:

- the FSAs between the HAB and the performing arts groups were in line with the prevailing government subvention guidelines on support for subvented organisations. It had not been the HAB's intention to seek a confirmation from an auditor on provisions of the FSA which touched on non-financial matters. The performing arts groups had engaged their auditors with the same understanding; and

- the HAB considered that the financial reports (including detailed financial statements) submitted by the performing arts groups had fulfilled the purpose of Annex C of the FSA of ensuring proper management and control of government funding. The subsequent amendments to Annex C were made to reflect better the intention of the clauses.

20. In response to the Secretary for Home Affairs' view set out in the last paragraph, **Mr Benjamin TANG, Director of Audit**, offered his comments to the Committee vide his letter of 14 June 2010 (in *Appendix 16*). He stated that:

- the requirements in Annex C of the FSA were made in accordance with Financial Circular No. 9/2004 which stipulated that:

"1.6 In all circumstances, they (Controlling Officers) should satisfy themselves that an appropriate system of cost control and monitoring is in place for overseeing the spending of public money by subvented organisations, having regard to economy, efficiency and effectiveness in the delivery of public service and use of public funds.

10.4 The auditors' report accompanying the annual financial statement and annual financial report submitted should contain an expression of opinion as to -

(a) **On the annual financial statements of the subvented organisation -**

whether they give a true and fair view of the state of affairs of the subvented organisation as at the balance sheet date and of its financial result and cash flows for the year then ended.

(b) **On the annual financial report of the subvented programme(s) being audited -**

whether the subvented organisation has complied with, in all material respects, the requirements set by the Government (including the requirements to keep proper books and records and to prepare annual financial report of the subvented programme(s) in accordance with the books and records) and all the terms and conditions of the subvention as specified in the relevant subvention guidelines and other relevant documents."; and

- in Audit's view, the previous audited financial reports (including detailed financial statements) submitted by the HKCO had only fulfilled the audit requirement in (a) above, but **not** the audit requirement in (b) above which

aimed to ensure the proper management and control of government funding. Therefore, Audit had reservation on the HAB's view that financial reports submitted in the past by the performing arts groups (including the HKCO) "had fulfilled the purpose of Annex C of the FSA of ensuring proper management and control of government funding".

21. To ascertain whether the FSA, as amended, could facilitate the auditor engaged by the HKCO to express an opinion on the financial report in the future and fulfil the FSA's purpose of ensuring that the government funding allocated to the HKCO had been properly managed and controlled, the Committee invited Audit's comments on the FSA for 2010-2011.

22. In his letters of 18 May 2010 (in *Appendix 17*) and 14 June 2010, the **Director of Audit** advised that:

- Audit understood that it was not the HAB's intention to seek audit assurance on non-financial provisions of the FSA. As a result, in Annex C of the FSA for 2010-2011, the HAB had modified the audit requirement in paragraph 10.4(b) of Financial Circular No. 9/2004 such that the auditor only had to express an opinion on the HKCO's compliance with the Government's requirements on the keeping of proper books and records as well as the accounting requirements in clauses 6(t), 8.1(d) and 10(d) of the FSA. As such, the auditor was no longer required to express an opinion on whether **all** the terms and conditions of the FSA had been complied with, as previously required under the FSAs of 2008-2009 and 2009-2010. The reduced audit scope under the 2010-2011 FSA would facilitate the auditor to express an opinion in the future. However, a number of other specific requirements of the FSA (which would hence fall outside the audit scope under the 2010-2011 FSA) were also important to the HAB as the Controlling Officer in monitoring the subvention to the HKCO. Examples included:
 - (a) clause 6(a) that required the HKCO to adopt proper internal controls to ensure that the subvention was used in a cost-effective and accountable manner;
 - (b) clause 6(h) that required the HKCO employees/agents/sub-contractors to observe the "Code of Conduct for Members of the Governing Board and Staff of Performing Arts Organisations", and the adoption of the proforma "Declaration of Conflict of Interest" (Annexes D and E to the FSA); and
 - (c) clause 6(u) that governed the procurement of goods and services to ensure that all procurement is conducted in a fair, unbiased and competitive bidding basis; and

- without the audit assurance, the HAB needed to consider adopting other measures to satisfy itself that such essential requirements of the FSA had been properly complied with by the performing arts groups, thereby ensuring that government funding to them had been properly managed and controlled. The HAB might wish to consult the FSTB in this regard.

23. In response to Audit's recommendation that the HAB should consider adopting measures to ensure compliance by the HKCO and other performing arts groups with some of the FSA clauses that were outside the audit scope under the 2010-2011 FSA, the **Secretary for Home Affairs**, in his letter of 8 June 2010, stated that the HAB would consult the FSTB and take appropriate follow-up actions.

24. The Committee referred to clause 5(d)(iii) of the 2010-2011 FSA which listed out the documents to be included in the HKCO's Annual Report and asked whether the HAB would review the clause because it was not clear as to what should be included. For example, the HAB could require the HKCO to publish the whole set of its financial statements on the company website and state such arrangement in its Annual Report. The **Secretary for Home Affairs** noted the suggestion.

25. Noting that a funding review of the subvented performing arts sector was under way, the Committee asked about the details and progress of the review. In his letter of 11 June 2010 in *Appendix 18*, the **Secretary for Home Affairs** stated that:

- the HAB had appointed a consultant in March 2010 to conduct a study on funding for the performing arts for the purpose of reviewing the objectives of public funding for the performing arts in Hong Kong, and drawing up a comprehensive proposal on a sustainable funding mechanism for government subvention of the performing arts groups, including looking into the assessment criteria as well as the level and models of public funding, to facilitate the flexible development of the sector; and
- the consultant was in the process of seeking views from arts groups and other stakeholders through interviews, focused group discussions and other means. The work of the consultant was scheduled for completion in 2011.

Criteria for evaluating the performance of the HKCO

26. According to paragraph 1.12(c) of the Audit Report, the Council Chairman of the HKCO had said that the sound governance and management of the company was valuable

only to the extent that it facilitated artistic development and achievement. She had further pointed out that as and when administration and bureaucracy threatened to consume time and resources to the point of stifling the HKCO's core work in arts and arts promotion, the HKCO should reconsider its priorities in the correct context. It appeared to the Committee that, in giving such response to Audit, the Council Chairman of the HKCO was aggrieved and did not agree with Audit's recommendations. The Committee enquired:

- whether this was the case; and
- whether the HKCO perceived any difficulties in implementing Audit's recommendations on the governance and management of the HKCO.

27. **The Council Chairman of the HKCO and Ms Celina CHIN, Executive Director of the HKCO**, said that:

- the HKCO truly agreed with Audit's recommendations. It was prepared to follow up and study the recommendations and would work closely with the HAB and the LCSO to ensure that appropriate measures would be taken for further improvement;
- the HKCO was not aggrieved, but had tried to explain the difficulties it faced, such as the difficulties in recording the artistic staff's actual working hours and lack of space for practices and rehearsals. The HKCO's biggest challenge was the need to balance between governing/managing and providing room for artistic development; and
- in the course of the Audit review, the HKCO had had good communication with Audit staff. Audit understood the difficulties faced by the HKCO as a performing arts group while the HKCO appreciated that Audit's evaluation was from a value-for-money perspective. Both Audit and the HKCO considered the review a health check with the objective of enabling the HKCO to further improve.

28. The Committee further referred to the response given by the Council Chairman of the HKCO in paragraph 1.12(c) of the Audit Report that it might not be very meaningful to just focus on the mechanistic administration and bureaucracy in any review of the HKCO, neglecting the more valuable yet intangible return the HKCO brought. The Committee asked whether the HKCO considered that apart from evaluating the HKCO's cost-effectiveness from the value-for money perspective, there should be other criteria for assessing its intangible artistic performance, such as its contribution towards the development of Chinese music and the audience's level of appreciation of its concerts.

29. The **Council Chairman of the HKCO** and **Ir Edmund LEUNG, First Vice-Council Chairman of the HKCO**, responded that:

- in the HKCO's view, value had both quantitative and qualitative aspects. In assessing the HKCO's performance, its artistic achievement and endorsement by local and international audiences should also be taken into account. In this connection, it should be noted that the HKCO had continuously been invited to perform on international tours. If a set of criteria was to be developed for evaluating the performance of arts groups, it should include qualitative criteria for measuring the arts groups' intangible achievements; and
- the HKCO was corporatised about 10 years ago for the purpose of enabling it to have greater autonomy in pursuing its artistic vision and more flexibility to optimise the use of public funding. As reflected in the FSA, the HKCO was not only required to meet financial targets but also achieve artistic mission. For instance, the HKCO should try to solicit more private sector sponsorship so as to reduce the proportion of government subsidy, while at the same time enhance its artistic performance and promotional work.

C. Governance and management

Functions of the HAB's representatives

30. The Committee noted from paragraph 1.6 of the Audit Report that the HAB's representatives attended the HKCO Council meetings as observers and received full sets of Council papers and minutes. The Committee also referred to the Secretary for Home Affairs' opening statement in which he mentioned that it was the HAB's duty to ensure that the performing arts groups had made proper use of public money in accordance with the principle of prudence. The Committee asked:

- about the functions of the HAB's representatives in attending the Council meetings and whether they included advising the HKCO on governance issues, such as compliance with the terms and conditions of the FSAs, so as to ensure the proper use of public money; and
- why the HAB's representatives had not raised queries about the HKCO's non-compliance with the audit requirement under the FSA before the problem was raised by Audit.

31. The **Secretary for Home Affairs** and the **Principal Assistant Secretary for Home Affairs (Culture)** explained that:

- the HAB's representatives were staff seconded from the LCSD who were familiar with this area of work. As observers, they were concerned with the implementation of the FSAs, but they did not participate in the governance of the HKCO. The HKCO operated as an independent company and its Council was responsible for governance matters; and
- the problem relating to the FSA's requirement on an auditor's opinion on the financial report did not concern the internal operation of the HKCO. It was an important policy matter which was beyond the competence of the HAB's representatives and the HKCO Council. It had to be dealt with by the HAB and the FSTB. Following Audit's advice, the HAB had sorted out the matter with the FSTB.

Members and Council members of the HKCO

32. As reported in paragraph 2.2 of the Audit Report, the HKCO's Articles of Association provided that the subscribers of the HKCO's Memorandum of Association were its first members. Other persons might apply for membership subject to the approval of the Council. It also provided that the Council of the HKCO should consist of not less than six or more than 20 members. At least two-thirds of Council members should be elected by members and not more than one-third of Council members should be appointed by the Government. The Committee asked whether:

- only members of the HKCO had the right to elect, and to be elected as, Council members; and
- any persons had applied for membership of the Council since the HKCO's incorporation in February 2001 and what the results were.

33. The **Council Chairman of the HKCO** replied at the public hearing and the **Executive Director of the HKCO** in her letter of 4 May 2010 (in *Appendix 19*) that:

- Council members were elected from among the HKCO's voting members; and

- in addition to the five subscribers of the Memorandum of Association of the HKCO who automatically became the first voting members of the HKCO, 22 persons had applied to become members of the HKCO since February 2001. All applications had been accepted. As at 4 May 2010, there were altogether 23 voting members in the HKCO.

34. In response to the Committee's request, the **Executive Director of the HKCO** provided a list of the members and Council members of the HKCO since February 2001 vide her letter of 10 June 2010 (in **Appendix 20**). The Committee noted that the number of members of the HKCO ranged from 9 to 23 at various times since its incorporation.

35. It appeared to the Committee that if a larger pool of HKCO members with a diversity of experience and expertise was available for the HKCO Council to draw its members, the new blood injected into the Council would be conducive to the HKCO's development. The Committee therefore enquired whether the HKCO had made any effort to attract more people to become its members.

36. The **Council Chairman of the HKCO** stated that it was difficult to attract people to be the HKCO's members because not many people were willing to contribute their time and efforts. As for Council members, the HKCO's Nomination Committee was responsible for, among other things, advising on the criteria for selecting Council members.

Policies and guidelines

37. The Committee noted from paragraph 2.4 of the Audit Report that the HKCO had compiled a set of Corporate Governance Guidelines to provide the Council and its members with defined direction of work and modus operandi. To guide its staff in managing the day-to-day operation, the HKCO had also laid down its administrative policies and procedures in the Accounting Policies and Procedures Manual ("PPM"), Human Resources PPM and Marketing and Development PPM. The Committee asked:

- who drafted the PPMs and whether they were practicable having regard to the nature and characteristics of the HKCO as a performing arts group; and
- whether any review had been carried out to ensure that the requirements in the PPMs were updated according to changing circumstances.

38. The **Council Chairman of the HKCO** replied that:

- the Corporate Governance Guidelines and the PPMs were drawn up by the Council of the HKCO as soon as the HKCO was corporatised. In preparing the guidelines and manuals, the Council had taken into account the HKCO's business as a Chinese orchestra and the requirements of the FSA, with a view to setting the standards and guidelines for the HKCO staff to follow; and
- the HKCO reviewed the guidelines and manuals on a regular basis and updated them according to changing circumstances.

Declaration of interests

39. According to paragraph 2.6(b) of the Audit Report, in its examination of the annual declarations of interests and the declarations of conflict of interests for meetings, Audit found that there were 22 occasions when some Council members of the HKCO did not submit a written declaration as to whether there was any conflict of interests in relation to the agenda items before attending the Council meetings held from October 2008 to September 2009. This was not in compliance with the HKCO's Corporate Governance Guidelines. The Committee asked about the reason for the non-compliance.

40. The **Council Chairman of the HKCO** and the **Executive Director of the HKCO** explained that on some occasions, the Council members concerned had in fact declared interests verbally at the meetings, but their declarations were not recorded in the minutes of meetings. Sometimes the HKCO's administration department had verbally followed up with those Council members who had not submitted the required declarations, but the follow-up actions and results were not documented. The HKCO accepted Audit's recommendation and would keep proper record of both verbal and written declarations in future.

41. The Committee further asked whether the HKCO was aware that any Council member had benefited by not declaring interests. The **Council Chairman of the HKCO** replied in the negative.

D. Core activities

Performance results reported to the Government

Complimentary ticket figures

42. According to paragraph 3.5 of the Audit Report, to account for its performance for each financial year, the HKCO was required under the FSA to submit to the Government a Self-evaluation Report. Paragraphs 3.7 to 3.9, however, revealed that Audit's examination of the 2008-2009 Self-evaluation Report on the HKCO's core activities (i.e. the conduct of regular concerts) found that the Report did not present a proper picture of the actual performance results of its core activities. The paid audience, attendance rates and ticket proceeds of its regular concerts were overstated while the number of complimentary tickets issued was understated.

43. Regarding the number of complimentary tickets reported by the HKCO, the Committee noted from paragraph 3.7(a) that the 1,941 complimentary tickets reported represented only the free tickets issued by the LCSD's Urban Ticketing System ("URBTIX") to the HKCO for distribution. Another 3,321 complimentary tickets purchased by the HKCO for promotional purposes were not included. The Council Chairman of the HKCO had said in paragraph 3.12(a) that it was a common practice in the local arts industry that the attendance rate was calculated based on the number of tickets sold at URBTIX plus complimentary tickets issued. The Committee asked whether this was indeed a common practice of the performing arts groups in Hong Kong, or the HKCO had understated the number of complimentary tickets intentionally in order to meet its performance targets set out in the FSA.

44. The **Principal Assistant Secretary for Home Affairs (Culture)** responded that:

- as far as he understood, the complimentary tickets included in the Self-evaluation Reports of other performing arts groups were the free tickets issued by URBTIX and such tickets had no face value. This was because even for performances held at the LCSD's venues, the LCSD staff might not be able to collect the ticket stub of every ticket. Moreover, the arts groups were encouraged to stage performances at non-LCSD venues where information on ticket stubs collected might not be available; and
- before the matter was raised by Audit, the HAB was not aware that the HKCO purchased a large number of tickets for free distribution as "complimentary tickets". In the past, the definition of complimentary tickets was not given in the form for use by arts groups to report their performance results, and hence there could be different interpretations of complimentary tickets. After the Audit review, the HAB had amended the report form and stated clearly that complimentary tickets were "tickets with no face value".

45. The **Council Chairman of the HKCO** and the **Executive Director of the HKCO** said that:

- given the need to more vigorously promote Chinese music by widening audienceship, the HKCO adopted the strategy of issuing HKCO-paid complimentary tickets for promotional purposes. The persons entitled to complimentary tickets included consular officials, Legislative Council Members, media, critics, the underprivileged and so on; and
- there was no question of the HKCO understating the number of complimentary tickets intentionally in order to meet the performance targets. The HKCO had consistently used the same basis for calculating the targets of complimentary tickets, paid audience and attendance rates etc as stated in the FSAs and for calculating the actual performance results. The HKCO had all along provided the information required in Self-evaluation Report form according to the requirements stated therein. As the HAB had revised the form to require more detailed breakdown of the performance results, the HKCO would provide the requisite information accordingly.

Attendance rates

46. The Committee noted from paragraph 3.7(d) of the Audit Report that in the 2008-2009 Self-evaluation Report, the attendance rates were arrived at by dividing the paid audience figures by an audience capacity pre-defined by the HKCO, instead of the maximum audience capacity of the venues where the concerts were held. The attendance rate based on the paid audience figure could have been overstated when the absence rate was high, as in case of a few concerts held in 2008-2009. There were also concerts for which the reported attendance rates exceeded 100% because the number of seats allocated for use was greater than the pre-defined audience capacity.

47. As stated in paragraph 3.7(d)(ii), the HKCO generally held its regular concerts at two LCSD venues, namely the Hong Kong Cultural Centre ("HKCC") Concert Hall and the Hong Kong City Hall ("HKCH") Concert Hall, with a maximum audience capacity of 2,005 and 1,434 seats respectively. However, the pre-defined audience capacity was only 1,496 (some 75% of 2,005) seats for the HKCC, and 1,206 (some 84% of 1,434) seats for the HKCH. The Committee enquired about the HKCO's rationale for setting the pre-defined audience capacity at such levels.

48. The Committee also referred to Audit's observation in paragraph 3.31 that the temporary blocking of more than 20% of the seats by the HKCO for concerts held at the HKCC was high as compared to the common practice of withholding only 14% in the case of concerts organised by another performing arts group. The Committee asked about the HKCO's reason for blocking so many seats from ticket sale.

49. The **Council Chairman of the HKCO** explained at the public hearing and the **Executive Director of the HKCO** in her letter of 4 May 2010 that:

- the pre-defined audience capacity was discussed and agreed under the broad principle of ensuring optimal viewing and most favorable acoustics effect for the audience. It was generally determined on a case-by-case basis, especially when the concert involved additional equipment such as an image projector, and other theatrical elements such as a dance or live performance of calligraphy. The less favorable seats would be released for sale, at a lower price, when all the other tickets had been sold, or the sightline problem proved to be acceptable during the final rehearsals. These measures were especially essential for ensuring a good experience for novice concert-goers who might otherwise be discouraged from coming back for more HKCO events in future;
- the HKCO understood that the case-by-case variation in the seating capacity of each concert might create difficulties for the HKCO's internal evaluation of programming and marketing effectiveness. It had therefore adopted a pre-defined audience capacity of 1,496 seats and 1,206 seats for the HKCC Concert Hall and the HKCH Concert Hall respectively. The defined capacity was for internal reference in the Self-evaluation Report only. The actual attendance figure instead of attendance rate was published in the HKCO's Annual Report to better reflect the full picture of attendance. The attendance rate might however be different, depending on the physical setting of the venue and the nature of the art form;
- the above practice had been approved by the HKCO Council after long and detailed discussions in a number of meetings where representatives from the LCSD were present; and
- the HKCO would comply with the revised requirements stated in the new report form to provide both the total seating capacity of the venue where the concert was held as well as the number of seats available for ticket sale according to the seating plan approved by the venue management concerned.

50. The Committee asked:

- about the HAB's established policy on the basis for determining attendance rates in the Self-evaluation Report; and
- how the HAB ensured that the HKCO had properly used government resources when there was such great discrepancy between the maximum audience capacity and the HKCO's pre-defined audience capacity.

51. The **Principal Assistant Secretary for Home Affairs (Culture)** stated that:

- generally speaking, the base figure for calculating the attendance rate was the number of seats allocated for sale of tickets or distribution, as agreed between the performing arts groups and the venue holder, which was the LCSD in the case of LCSD venues. The HAB understood that an arts group might want to achieve different artistic effects for different concerts. Thus, it would not be desirable to stipulate that the maximum audience capacity of a venue must be used as the base figure for calculating the attendance rate;
- the HAB respected the practice of the arts groups and considered it appropriate to let the LCSD discuss with the arts groups the number of seats that should be made available for ticket sale, having regard to the desired artistic effect of a performance and the need to ensure the effective use of its venues; and
- the HAB had amended the report form to require all the nine subvented performing arts groups to report the audience capacity in terms of the total seating capacity of a venue and the number of seats available for ticket sale/distribution approved by the venue management concerned.

52. In his letter of 8 June 2010, the **Secretary for Home Affairs** provided a copy of the revised Self-evaluation Report form to the Committee. He also stated that:

- the HAB had worked out a detailed proforma to facilitate the major performing arts groups to report the performance results of their core programmes in their respective Self-evaluation Report; and
- the new proforma had incorporated the recommendations put forth in the Audit Report. It provided clear definitions and methodologies on the performance information to be included in the Report, such as the maximum venue capacity, the maximum audience capacity stated in an approved seating plan, the number of paid audience, the number of complimentary tickets (including free tickets or complimentary tickets paid by the arts group), and the formulas for calculating ticket proceeds and ticket sale rates.

Strategy and monitoring system for issuing complimentary tickets

53. According to paragraph 3.15 of the Audit Report, as compared with the complimentary ticket strategy of the LCSD which similarly held a lot of cultural/festival presentations/events each year, the HKCO's complimentary ticket strategy was more generous and its monitoring system more relaxed. The Committee asked:

- about the HAB's view on the HKCO's strategy; and

- given that URB TIX only allowed up to a maximum number of 60 complimentary tickets for each performance, whether other performing arts groups also had the practice of purchasing tickets for free distribution to different categories of persons, such as commercial sponsors, so as to meet their needs.

54. The **Secretary for Home Affairs** responded that the HAB had no intention to require the subvented performing arts groups to adopt the same strategy for issuing complimentary tickets as the LCS D because they were not directly managed by the Government. However, they were required to ensure value for money in using public funds. It was up to the Council of the HKCO to decide on matters like whether quotas on complimentary tickets should be set.

55. The **Principal Assistant Secretary for Home Affairs (Culture)** supplemented that other performing arts groups also had the practice of purchasing priced tickets for free distribution to different persons and organisations, such as sponsors, schools and the underprivileged. However, they would break down the number of tickets sold for a performance into those that had no face value, those that were paid for by the audience, and those that were purchased by the arts groups themselves for free distribution. The problem concerning complimentary ticket figures in the HKCO's Self-evaluation Report had arisen due to unclear reporting and presentation.

56. The Committee further asked about the HKCO's criteria for issuing complimentary tickets to commercial sponsors, and whether the HKCO would take into account the amount of sponsorship received in determining the number of complimentary tickets issued to the sponsor concerned.

57. In her letter of 8 June 2010 in *Appendix 21*, the **Executive Director of the HKCO** replied that:

- a set of guidelines on the distribution of complimentary tickets had been laid down in the Marketing and Development PPM by the Marketing Committee and endorsed by Council: an agreed number of complimentary tickets would be given to the sponsors according to the size of the sponsorship with flexibility to be exercised as stated in the manual; and
- the number of tickets to be offered was based on the following criteria:
 - (a) the brand value and relevance of the sponsor to the HKCO;
 - (b) profile of clients/guests to be invited by the sponsor to the concert and the HKCO;

(c) new opportunities for the HKCO to promote Chinese orchestral music to non-regular concert goers; and

(d) the potential to establish long-term partnership with the sponsor.

58. The Committee noted the distribution of the complimentary tickets issued in 2008-2009 by recipient categories, as set out in Table 5 in paragraph 3.14 of the Audit Report. The Committee asked whether:

- the HKCO reviewed the categories of persons entitled to complimentary tickets on a regular basis; and
- the HKCO issued complimentary tickets to non-governmental organisations ("NGOs") and schools to help promote Chinese music to the community.

59. The **Council Chairman of the HKCO** and the **First Vice-Council Chairman of the HKCO** responded that:

- the recipient categories of complimentary tickets were reviewed and adjusted every year. The HKCO's ultimate goal was to increase the number of audience who paid for the tickets and reduce the issuance of complimentary tickets;
- schools and NGOs, including the underprivileged groups, were also recipients of the HKCO's complimentary tickets. The HKCO would take into account the nature of a concert in issuing the tickets to different categories of audience. For instance, if a concert was more international, the HKCO might issue complimentary tickets to consular officials, hoping that they would help bring Chinese music to different countries. For schools in remote areas, the HKCO would make arrangements for the students to attend concerts held in the HKCC;
- the HKCO had encountered practical difficulties in issuing complimentary tickets to schools. When the HKCO tried to offer complimentary tickets to schools when the ticket sale for a particular performance was not good, which would normally be known about two or three weeks before the performance was held, the schools indicated that the lead time was too short for them to distribute the tickets. Hence, there was a need to work out systematic arrangements for issuing complimentary tickets to schools; and
- the HKCO would also review the ratio of complimentary ticket distributions among different categories of recipients to see if there was room for improvement.

60. The Committee noted from paragraph 3.22(b) of the Audit Report that from an examination of seven concerts (involving 12 performances) held in 2008-2009, Audit found that in many cases, there were no justifications on record, and no written approvals had been obtained, for issuing additional complimentary tickets. In some cases, additional complimentary tickets were issued "with verbal approval from the Council Chairman" without evidence that written approval had subsequently been given. Case 3 and Case 4 were examples. The Committee questioned whether these cases reflected that the HKCO had been lax in governance matters and had not paid due regard to compliance with its own rules and requirements.

61. The **Council Chairman of the HKCO** and the **Executive Director of the HKCO** explained that:

- the HKCO attached high importance to corporate governance and compliance matters. The Marketing and Development PPM set out the maximum number of complimentary tickets that could be issued for different purposes. It also provided flexibility for the Executive Director to seek approval from the Chairman of the Marketing Committee/Council Chairman for issuing additional complimentary tickets where situation warranted. Sometimes because of the urgency of situation, the Executive Director might seek verbal approval from the Council Chairman or the Chairman of the Marketing Committee by phone first, followed by a written report to the Council. The written reports were discussed at meetings of the Council. However, this procedure was not recorded in the minutes of meetings; and
- regarding Case 3 and Case 4, verbal approval for issuing additional complimentary tickets had been sought from the appropriate authority, but no written record of the justifications and approval was kept. Following Audit's advice, the HKCO would improve its documentation.

62. The Committee noted that in Case 4, the HKCO had issued a total of 155 complimentary tickets to two local media firms. The Committee asked about the business nature of the media firms.

63. In her letter of 4 May 2010, the **Executive Director of the HKCO** stated that the two media firms were local newspapers. The complimentary tickets were provided to the newspapers in exchange for promotion and publicity in their papers. This was a common public relations and marketing bartering strategy to promote HKCO's concerts and to feed first-hand experience in the appreciation of Chinese orchestral music to their readers. The net benefits of such arrangements were far greater than the income from the sale of the tickets concerned.

Regular concerts held as "private functions" for commercial sponsors

64. According to paragraph 3.23 of the Audit Report, there were two occasions (Case 5 in 2008-2009 and Case 6 in 2009-2010) when the HKCO's regular concerts were arranged as "private functions" (i.e. with no public sale of tickets) for commercial sponsors. On each of the occasions, the sponsorship was unable to cover the full cost of the performance. As pointed out by Audit, the arrangements for these two concerts could give rise to problems such as cross-subsidisation of private functions by government fund. The Committee asked about the HKCO's reasons for changing its regular concerts to private functions for commercial sponsors and whether there were established criteria in this regard.

65. The **Council Chairman of the HKCO** and the **First Vice-Council Chairman of the HKCO** explained that:

- it was the HKCO's aim to promote public private partnership and encourage sponsorship from the private sector, with a view to lowering the subsidy rate. The HKCO's strategy on the solicitation of sponsorship had been deliberated and endorsed by the Marketing Committee and there were guidelines on sponsorship programmes. The Marketing Committee had endorsed the holding of the two concerts for the sponsors based on commercial considerations and had reported to the Council; and
- the HKCO had a programme of regular concerts in each orchestral season. It would not specially stage a concert for a commercial organisation, but a commercial organisation could sponsor the regular concerts. The two cases referred to in the Audit Report as "private functions" were regular concerts which had been planned as part of the programme in the orchestral season. Moreover, holding the concerts as private functions could also bring new audiences who might otherwise not be exposed to Chinese music. From this perspective, the private concerts could help to promote Chinese music.

66. The Committee noted that one performance each of the two concerts mentioned in Case 5 and Case 6 were open to the public for ticket sales. To ascertain whether members of the public had been deprived of the opportunity to attend the concerts due to the change from open performances to private functions, the Committee asked about the respective numbers and percentages of the tickets sold for the open performances. In her letter of 4 May 2010, the **Executive Director of the HKCO** provided the information requested by the Committee, as follows:

	<u>Case 5</u>	<u>Case 6</u>
Number of tickets sold (to the public only)	905 (57.57%)	1,592 (92.02%)
Total number of tickets sold (including promotional tickets bought by the HKCO)	1,039 (66.09%)	1,663 (96.12%)

67. The Committee further asked about the principles adopted by the HKCO Council and/or the Marketing Committee for holding private functions for commercial sponsors, and whether the private concerts in question had breached the rules for using the venues. The **Executive Director of the HKCO** informed the Committee vide her letter of 8 June 2010 that:

- despite that Chinese orchestral music had about 90 years of development, it was still much less established in the global arts world compared to its western counterparts, where the development of symphony orchestras dated back over 300 years. As such, the HKCO had to adopt an aggressive marketing strategy to vigorously promote Chinese orchestral music and broaden audience base;
- the HKCO accepted private sponsorship for the two concerts in question based on the following principles/consideration:
 - (a) to bring in extra income which, in turn, would help reduce government subsidy;
 - (b) it was an opportunity to tap/broaden into new/potential audience through networks of the sponsors; there would be a guaranteed number of audience through the sponsors' network; and
 - (c) the sponsors' brands could be leveraged to enhance the HKCO's own brand and marketing efforts in seeking more sponsorships in the future; and
- in terms of the use of the venue, the HKCO had complied with all requisite requirements in these two concerts as with all other concerts.

68. Regarding the private function mentioned in Case 6, Audit reported that the HKCO received a sponsorship of less than \$400,000 from the sponsoring company. However, the HKCO spent some \$358,000 on purchasing 1,662 complimentary tickets (including 1,630 issued to the sponsoring company). The HKCO also incurred another \$350,000 on overseas artists' and performers' fees, venue rental, and marketing expenses. This meant that the performance was held at a deficit, even without including any indirect expenses. Moreover, the issuance of 1,630 complimentary tickets to the sponsoring company exceeded the sponsor's entitlement under which 200 complimentary tickets should have been issued.

69. The Committee questioned why the HKCO had issued such a large number of complimentary tickets with a value which was disproportionately high when compared to the amount of sponsorship received, and consequently giving rise to a large amount of deficit. The Committee also asked whether the HKCO would review its criteria for holding private functions for, and issuing complimentary tickets to, commercial sponsors, so as to prevent the occurrence of similar situation in future.

70. The **Council Chairman of the HKCO** and the **Executive Director of the HKCO** responded that:

- the private function in question was in fact a regular concert which would be held whether there was sponsorship or not. It was not staged by the HKCO specially for the sponsoring company;
- it was the HKCO's long-term strategy to encourage sponsorship from the private sector. The HKCO accepted the sponsorship in question because the estimated money generated from ticket sales of the performance was only about \$230,000 whereas the amount of sponsorship was \$350,000. This was because if the performance was open for public sale of tickets, a number of tickets would be sold at a concessionary rate, such as those for students and senior citizens. Therefore, the sponsorship had generated more financial return to the HKCO and reduced the subsidy by the Government. Moreover, the sponsor would help to bring more audience to the concert; and
- following the Audit review, the Marketing Committee would review the HKCO's strategy of sponsorship to identify ways of improvement. The HAB would also be consulted.

71. The Committee further asked whether the HAB's representatives who attended the HKCO Council meetings knew that the HKCO had changed its regular concerts to private functions for commercial sponsors, and if they knew, whether they had raised any objection.

72. In his letter of 8 June 2010, the **Secretary for Home Affairs** advised that:

- based on the discussion at the HKCO's Council meetings, the two concerts mentioned in paragraph 3.23 of the Audit Report were arranged with the aims to increase revenue and broaden the audience base. As such, the HAB's observer did not raise objection to the arrangement; and
- the HAB also noted that the HKCO had paid full rental for hiring the LCSD's venue for the said concerts and did not receive rental subsidy.

73. The Committee referred to Audit's comments on Case 5 and Case 6 that the HKCO should charge the commercial sponsors of the private functions the full cost of the concerts, so as to avoid cross-subsidisation of private functions by government fund. Noting that the full cost of a concert included both the direct and indirect costs (e.g. apportionment of the musicians' salaries), the Committee enquired:

- in the HKCO's view, whether Audit's recommendation was feasible;
- about the HAB's policy regarding charging full cost for the private functions held by performing arts groups; and
- given that it would be difficult for some performing arts groups to solicit sponsorship if the sponsors were required to pay the full costs of the sponsored activities, the Committee asked whether the HAB would consider allowing the arts groups to hold sponsored events with a certain degree of government subsidy, so as to help promote the performing arts to the community.

74. The **Council Chairman of the HKCO** responded that the full cost of staging a concert was very high and it was unlikely that an organisation would be willing to spend such a large amount of money to sponsor a concert. The HKCO would seriously follow up Audit's recommendation and consult the HAB with a view to identifying an appropriate direction for future development.

75. The **Secretary for Home Affairs** and the **Principal Assistant Secretary for Home Affairs (Culture)** responded that there was no provision governing the holding of private functions for sponsors in the HAB's FSAs with all the nine subvented performing arts groups, including the HKCO. As regards whether arts groups should charge full cost for sponsored events, it would depend on the situation of each arts group and each art form. For the time being, the HAB had no intention to impose such a requirement on the performing arts groups, although full cost recovery was a goal to be achieved in the long term.

76. The Committee noted that the HKCO had been corporatised for almost 10 years but its cost recovery rate was only 18%, meaning that 82% of its expenditure was met by the Government, and this appeared to be on the high side. The Committee therefore asked whether the Government had set a target cost recovery rate for the HKCO each year with a view to reducing the government subsidy rate gradually and ensuring the proper use of public money.

77. The **Principal Assistant Secretary for Home Affairs (Culture)** stated that there was no such target under the current mode of subvention. One of the aims of the funding review was to draw on the experience of overseas countries with a view to establishing some objective criteria for determining the mode of funding for different performing arts groups.

E. Human resources management

Working hours of artistic staff

78. According to paragraph 4.2 of the Audit Report, with the exception of the Artistic Director, the resident conductor and the research and development officer, other artistic staff of the HKCO were required under their employment contracts to work 28 hours a week. Paragraph 4.4, however, revealed that based on a sample checking of the 2008-2009 duty rosters and attendance records of the artistic staff, Audit found that the actual working hours of 20 of them averaged 703, which were 533 (43%) less than the conditioned working hours of 1,236 for that year.

79. The Committee noted that the working hours of artistic staff included the time spent on rehearsals and self-practices, and musicians might work on their own at venues outside the HKCO's office. Moreover, if there were insufficient venues for rehearsals and self-practices at the HKCO, artistic staff might be forced to practise elsewhere. All these factors would add to the difficulties in recording the time spent by artistic staff on self-practices and in monitoring whether their conditioned working hours had been fulfilled. The Committee therefore enquired about:

- the duties of the 20 artistic staff whose actual working hours were less than the conditioned working hours in 2008-2009, as mentioned in Table 9 in paragraph 4.4 of the Audit Report, as well as the musical instruments they played; and
- the venues provided by the HKCO for self-practices and small group rehearsals by its artistic staff, and whether the venues were sufficient.

80. In the attachment to her letter of 4 May 2010, the **Executive Director of the HKCO** provided the duties of the 20 artistic staff and the musical instruments played by them. The Committee also noted the supplementary information on the artistic staff's actual working hours provided by the **Director of Audit** vide his letter of 10 May 2010 (in *Appendix 22*).

81. Regarding the space for sectional rehearsals and self-practices, the **Executive Director of the HKCO** stated at the public hearing and in her letter of 4 May 2010 that:

- there were one large hall and two small rehearsal rooms at the HKCO's base at the Sheung Wan Municipal Services Building. The facilities were grossly insufficient for all of the HKCO's sectional rehearsals and self-practices. The smaller rehearsal rooms were extremely inadequate for instruments like Suona, Sheng or Percussion due to their high volume. Very often musicians had to make use of any space at the Sheung Wan base, such as sitting or standing in the corridors to practise, or practise during the odd hours. The time spent on such sporadic self-practices could not be recorded; and
- in view of the lack of space for rehearsals and self-practice sessions, the HKCO had submitted a document to the West Kowloon Cultural District Authority dated 11 December 2009, proposing to the Authority, among other suggestions, to designate a regular and appropriate venue for the HKCO for rehearsals and practice sessions, which would be instrumental to the professional development of the HKCO.

82. The Committee also understood from paragraph 4.9(d) of the Audit Report that when musicians were required to play new or difficult scores, they would have to devote more time to self-practice. To better understand the impact of new scores on the actual working hours of artistic staff, the Committee asked about the number of pages of new scores which musicians were required to play, and the average time required for analysing and becoming familiar with one page of the new scores, in each of the past two years.

83. The **Council Chairman of the HKCO** stated that the HKCO had commissioned over 1,900 new pieces and the musicians had devoted considerable time to practising them. Another example was a concert staged in March 2010 at the Hong Kong Arts Festival. Musicians were required to play 298 pages of new scores. On average, it took 30 minutes to one hour for a musician to analyse and become familiar with one page of a new or difficult score. Therefore, a total of 149 hours were required in addition to the 28-hour per week rehearsals for this concert.

84. In her letter of 8 June 2010, the **Executive Director of the HKCO** informed the Committee that:

- the HKCO played a total of 1,148 and 1,183 pages of new score music for the 31st season (August 2007 to July 2008) and the 32nd season (August 2008 to July 2009) respectively;
- the average time required for analysing and becoming familiar with one page of new scores was a highly complex consideration which might be risky to generalise. This was because the creativity, complexity and difficulty of each composition varied, often drastically, from one to another. Even for the same composition, different conductors might interpret the music differently according to the different orchestras and occasions in question. Their requirements on the musicians, which were often linked to the practice time required, were thus different;
- in addition to newly commissioned pieces, musicians were also required to prepare for other pieces and practise on their own before coming to group rehearsals. Even for "old" pieces, there would be new interpretations by different conductors and/or on different occasions and musicians still needed to practise to achieve artistic excellence; and
- in view of the dynamism and complexity of orchestral music, which was subject to the creativity of composers and conductors, it was very difficult to generalise for all concerts and all pieces on the average time required for musicians to analyse and become familiar with music scores.

85. Having regard to the fact that artistic staff were required under their employment contracts to work 28 hours a week, the Committee wondered whether such requirement had taken into account the need for self-practice and the dynamism and complexity of orchestral music. The Committee further asked how the terms and conditions of the employment contracts were arrived at.

86. The **Council Chairman of the HKCO** said that:

- the terms and conditions had been evolving over the years. They were first introduced by the LCSD and then adopted by the HKCO upon incorporation, with adjustments based on legal advice;
- the working hours stipulated in the employment contracts were included to protect the right of the orchestra, as it empowered the HKCO to require a specified number of hours for group rehearsals. The weekly working hours of 28 were agreed between the HKCO and the musicians after much discussion with the trade union. The artistic staff understood that they were

required not only to fulfil the conditioned working hours but also to achieve the required artistic standard; and

- the HKCO understood that the artistic staff's actual working hours would be longer than those stated in the employment contracts. That was why the HKCO had introduced the 360 degree performance assessment scheme in order to ensure that the musicians performed up to artistic standards and requirements.

87. As regards the details of the 360 degree performance assessment system, the **Executive Director of the HKCO** informed the Committee vide her letter of 4 May 2010 that:

- the assessment not only encompassed a review of each musician's performing artistic capability, but also gave an indication on the musician's professionalism, team spirit, cooperation with others, discipline and demeanour, etc. Depending on the assessed musician's position and grade, an assessment was done by at least two tiers of immediate supervisors. Contract renewal or salary adjustment cases were discussed thoroughly by the Human Resources Committee and the Council of the HKCO; and
- on top of the assessment of individual musician's performance, the HKCO also adopted a system whereby senior musicians of the artistic department starting from Assistant Principals upwards would appraise, for virtually each concert, the performance of other musical sections or individual musicians from other musical sections. The senior musicians would also be asked to evaluate the guest conductors and soloists, as well as the venue facilities and score preparation for future reference.

Other issues

88. According to paragraph 4.7 of the Audit Report, the artistic staff worked less than the conditioned hours in December 2008, but were granted time off on two occasions, which were not consistent with the contract provisions. On one occasion, the actual practising time exceeded the scheduled three hours by three minutes only but one-day time off was granted to all participating artistic staff. On the other occasion, one-day time off was granted to all participating artistic staff for an anticipated 30-minute overtime ("OT") work due to the early start of the following day's rehearsal. The Committee queried why the HKCO was so generous in granting time off to its artistic staff.

89. The Committee also noted from paragraph 4.12 of the Audit Report that three outgoing artistic staff were paid \$323,000 salaries from mid-May to end of August 2009 but were not assigned any duties during the period. The Committee asked why the HKCO adopted such an arrangement instead of dismissing them by giving one month's notice according to the employment contract.

90. The **Council Chairman of the HKCO** responded that:

- in the past, OT work was compensated by OT pay. After discussion with the trade union, OT pay was stopped and OT work was compensated by time off. Very often, time off was granted during the "slow" months for the HKCO;
- it was not the HKCO's practice to grant one-day time off to the artistic staff whenever they worked beyond the scheduled hours by three minutes. On the two occasions mentioned by Audit, more time off had been granted because December was a "slow" month; and
- in deciding whether a staff should be terminated, the HKCO would take into account its possible impact on individuals and the morale of the HKCO as a whole. However, in view of Audit's recommendation, the HKCO would explore ways to minimise any nugatory expenditure.

91. As revealed in paragraphs 4.21 and 4.24 of the Audit Report, there were cases of non-compliance with the HKCO Human Resources PPM in the provision of air passage and lodging for duty visits outside Hong Kong in 2007 and 2008. The Committee also noted the response of Council Chairman of the HKCO set out in paragraph 4.26(d) that in the cases concerned, the HKCO respected the organisers' consideration based on their budget and the desire for the HKCO to be positioned consistently with its international standing.

92. The Committee asked whether the HKCO would amend its policy to the effect that its staff could accept the class of air passage and lodging provided by organisers in consideration of the HKCO's international standing. The **Council Chairman of the HKCO** agreed and said that the Human Resources PPM had already been amended to cater for such situation.

F. Other administrative issues

93. According to paragraphs 5.13 and 5.17 of the Audit Report, in 2003, the HKCO purchased 1,975 drums at a cost of \$976,000 for the first Drum Festival. Audit found that while the drums were excessive to the HKCO's normal requirement, the HKCO did not formulate a disposal plan in 2003. In the event, storage cost totalling \$617,000 was incurred and 623 drums were damaged before they could be disposed of by sale or donation. The Committee enquired whether the HKCO Council had discussed how to dispose of the drums in 2003.

94. The **Council Chairman of the HKCO** replied that:

- the Council had discussed the matter at that time. The drums were purchased for the opening rally of the first Drum Festival which was part of the Economic Relaunch Programme organised by the Government after the Severe Acute Respiratory Syndrome outbreak in 2003. The Drum Festival was well received and the HKCO continued to organise drum festivals every year during which the drums would be used. A number of the drums were given away as gifts after a performance in the United States. Also, some drums had been sold or donated; and
- as for the storage of the drums, the HKCO had made enquiries with the LCSD but was told that no storage space was available. In the circumstances, the HKCO could only rent storage space for storing the drums. The rental cost had in fact been decreasing over the years. The \$617,000 was the accumulated rental costs of the past seven years.

95. Noting that 623 drums were damaged by moulds and wood-boring insects, the Committee queried whether the storage space rented by the HKCO was suitable for storing musical instruments.

96. The **First Vice-Council Chairman of the HKCO** and the **Executive Director of the HKCO** explained that:

- it was the HKCO's original plan to hold a drum festival in September 2003. However, to tie in with the Government's Economic Relaunch Programme, the festival was advanced to 13 July 2003. Moreover, as more than 3,100 people wanted to participate in the festival, the HKCO had to buy a lot of drums within a short time. Given that the Drum Festival was considered a one-off project, the HKCO did not demand drums of a very high quality. As the event had been advanced from September to July, perhaps the wood of some drums was not yet dry enough then and hence was easily damaged; and

- with hindsight, it might be more advisable if the HKCO had chosen to dispose of the drums shortly after the Drum Festival, such as selling them regardless of the financial return, instead of keeping them for future use.

97. It appeared to the Committee that the HKCO did not have adequate government support for the provision of space for practice and storage. The Committee asked how the HAB would meet the needs of the HKCO.

98. The **Secretary for Home Affairs** responded that the HAB understood that in promoting the development of arts and culture in Hong Kong, apart from providing performance venues for arts groups, the Government should also provide space for practice and other support facilities. On the other hand, the HAB respected an arts group's autonomy and would not intervene in matters relating to its performance, such as the need to procure a large number of drums to produce certain artistic effect.

G. Conclusions and recommendations

99. The Committee:

- affirms the efforts made by the Hong Kong Chinese Orchestra Limited ("HKCO") to promote and develop Chinese music in Hong Kong;
- recognises that the audit review was focused on the governance and management issues of the HKCO and did not in any way reflect on the artistic performance of the HKCO's work;

Criteria for evaluating subvented performing arts groups

- expresses concern that the Home Affairs Bureau ("HAB") may not have the necessary expertise in arts administration to enable it to establish a set of qualitative and quantitative criteria for evaluating the proper needs of a subvented performing arts group, such as the HKCO, in the absence of which the HAB appears to have allocated the regular subventions as a matter of routine. As a result:
 - (a) Audit only evaluated the HKCO on the basis of cost-effectiveness. It may not be entirely satisfactory to evaluate a performing arts group on such a basis alone without reference to its artistic needs;

- (b) when taking over the funding responsibilities for major performing arts groups from the Leisure and Cultural Services Department ("LCSD") in April 2007, the HAB inherited the LCSD's Funding and Services Agreement ("FSA") with the arts groups, including the requirement for an auditor's opinion on all the provisions of the FSA, although some provisions touched on non-financial matters (e.g. the HKCO's artistic mission) and were practically not auditable; and
 - (c) from 2005-2006 to 2008-2009, although the LCSD/HAB was aware that the audited financial reports submitted by the HKCO were not in strict compliance with the audit requirement stipulated in the FSA because they did not contain an audit opinion on the financial report of the subvented activities, the LCSD/HAB failed to take action to address the non-compliance. It was only in March 2010 after the matter had been raised by Audit that the HAB dealt with the problem by simply reducing the audit scope required under the 2010-2011 FSA, instead of improving the audit requirements in the FSA. This gives rise to concern that the amended FSA may not be able to fulfil its purpose of ensuring that the government funding allocated to the HKCO has been properly managed and controlled;
- acknowledges that:
- (a) the HAB appointed a consultant in March 2010 to conduct a study on funding for the performing arts for the purpose of reviewing the objectives of public funding for the performing arts in Hong Kong, and drawing up a comprehensive proposal on a sustainable funding mechanism for government subvention of the performing arts groups, including looking into the assessment criteria as well as the level and models of public funding, to facilitate the flexible development of the sector. The work of the consultant is scheduled for completion in 2011; and
 - (b) the Secretary for Home Affairs has accepted Audit's recommendation that the HAB should, in consultation with the Financial Services and the Treasury Bureau ("FSTB"), consider adopting measures to ensure compliance by the HKCO and other performing arts groups with some of the FSA clauses which are outside the revised audit scope under the 2010-2011 FSA, e.g. clause 6(a) on internal controls, clause 6(h) on code of conduct (for Board members and staff) and declarations of conflict of interest, and clause 6(u) on procurement;

- urges the Secretary for Home Affairs to:
 - (a) acquire the necessary expertise in arts administration so as to establish a set of qualitative and quantitative criteria for evaluating the proper needs of subvented performing arts groups, including the HKCO;
 - (b) promptly improve the monitoring mechanism for performing arts groups by taking into account the outcome of the consultancy study and the need to strike a proper balance between safeguarding artistic autonomy and ensuring the proper use of public money, consulting the major performing arts groups, the Panel on Home Affairs of the Legislative Council ("HA Panel") and other stakeholders, and to report progress to the HA Panel; and
 - (c) consult the FSTB and adopt measures to ensure compliance by the HKCO and other performing arts groups with all the provisions in the FSA, including those which are outside the revised audit scope under the 2010-2011 FSA, e.g. clauses 6(a), 6(h) and 6(u), with a view to ensuring proper management and control of public funding;

Governance and management

- considers that sound governance and management are essential to the success of the HKCO as a subvented performing arts group, including the achievement of its artistic vision, and disagrees with the view expressed by the HKCO that sound governance and management are valuable only to the extent that it facilitates artistic development and achievement;
- expresses concern about the small membership size of the HKCO (ranging from 9 to 23 at various times) since its incorporation in 2001 because, if a larger pool of members with a diversity of experience and expertise is available for the HKCO Council to draw its members, the new blood injected into the Council will be conducive to the development of the HKCO;
- acknowledges that:
 - (a) the Council Chairman, HKCO has agreed with the recommendations mentioned in paragraph 2.11 of the Director of Audit's Report ("Audit Report"). The HKCO will work closely with the HAB to ensure proper follow-up for improvement; and
 - (b) the Secretary for Home Affairs has agreed to implement the recommendations mentioned in paragraph 2.12 of the Audit Report;

- urges the HKCO to:
 - (a) critically review its Corporate Governance Guidelines, Accounting Policies and Procedures Manual ("PPM"), Human Resources PPM, Marketing and Development PPM, and other relevant regulations and guidelines to ensure that they are in line with good governance and management principles while at the same time practicable, having regard to the nature and characteristics of the HKCO's work; and
 - (b) proactively attract more people to become HKCO members as an avenue for bringing in more new ideas and expertise to the Council of the HKCO to help in its development;
- urges the Secretary for Home Affairs to:
 - (a) facilitate the dissemination of information on governance and management practices adopted by some performing arts group for reference by other arts groups, with a view to raising the standard of governance and management; and
 - (b) require the HAB's representatives who attend the HKCO Council meetings to proactively inform the HKCO of relevant government practices and guidelines for reference by the HKCO where appropriate;

Core activities

- expresses concern that:
 - (a) the HKCO's 2008-2009 Self-evaluation Report did not present a proper picture of the actual performance results of its core activities in that the paid audience, attendance rates and ticket proceeds of its regular concerts were overstated while the number of complimentary tickets issued was understated;
 - (b) a proper and complete written record of complimentary ticket requests and acknowledgement, and of the justifications and approvals for additional complimentary tickets issued, was not always maintained; and
 - (c) the temporary blocking of more than 20% of seats from ticket sales for some concerts is not conducive to efficient and effective use of resources, as those seats could have been offered to schools and other suitable organisations to help promote Chinese music among the younger generation and other specific sectors of the community, including the underprivileged;

- regrets that the HKCO does not have a clearly defined policy with objective criteria for holding private functions (i.e. with no public sale of tickets) for commercial sponsors, which could give rise to problems such as cross-subsidisation of a private function by government fund in the case of the two concerts (one in 2008-2009 and another in 2009-2010) identified by Audit;
- acknowledges that:
 - (a) the Secretary for Home Affairs has worked out a detailed proforma to facilitate the performing arts groups to report the performance results of their core programmes in their respective Self-evaluation Reports. The new proforma provides clear definitions and methodologies on the performance information to be included, such as the number of paid audience, the number of complimentary tickets and the formulas for calculating ticket proceeds and ticket sale rates; and
 - (b) the Council Chairman, HKCO has agreed with the recommendations mentioned in paragraphs 3.10, 3.25 and 3.32 of the Audit Report. The HKCO will work closely with the LCSD and the HAB to ensure proper follow-up for improvement;
- urges:
 - (a) the Secretary for Home Affairs and the Council Chairman, HKCO to take measures to promote Chinese music to the community and report to the HA Panel;
 - (b) the HKCO to devise objective criteria for changing its regular concerts to private functions for commercial sponsors; and
 - (c) the HKCO, instead of temporarily blocking a large number of less favorable seats from ticket sales, to work out arrangements with schools and other suitable organisations with a view to offering the seats to them, thereby optimising the use of resources and helping to promote Chinese music to targeted sectors of the community, including the underprivileged;

Human resources management

- expresses concern that:
 - (a) due to the lack of sufficient space for the HKCO's sectional rehearsals and self-practices, some artistic staff have to practise at places outside the HKCO's base at the Sheung Wan Municipal Services Building, making it difficult to monitor whether their conditioned working hours have been fulfilled;

- (b) artistic staff were granted more annual leave than their entitlement in the three employment contracts years from 2005-2006 to 2007-2008;
 - (c) three outgoing artistic staff were paid salaries for the period from mid-May 2009 to the end of their contracts (on 31 August 2009), but were not assigned any duties for this period;
 - (d) there were cases of non-compliance with the HKCO Human Resources PPM in the provision of air passage and lodging for duty visits outside Hong Kong in 2007 and 2008;
 - (e) the HKCO had not agreed with the research and development (R&D) officer on the contract terms for managing intellectual property right and research cost before he commenced research work on items not specified in his employment contracts. In the event, research cost was incurred by the R&D officer without budgetary control, and the HKCO paid \$350,000 for the research products and the related intellectual property right; and
 - (f) the HKCO did not set milestone dates in the R&D officer's employment contracts (September 2003 to August 2011) for measuring the progress of his research work;
- acknowledges that:
- (a) the Council Chairman, HKCO has agreed with the recommendations mentioned in paragraphs 4.8, 4.14, 4.25 and 4.35 of the Audit Report; and
 - (b) the HKCO's Human Resources Committee has ratified the HKCO's guidelines to tie in with its existing policy regarding air passage and lodging provision for performance tours as opposed to duty visits;
- urges:
- (a) the Secretary for Home Affairs to take measures to ensure that adequate support facilities, including space for rehearsals and self-practices and storage of musical instruments, are provided to the HKCO, such as by providing a proper home base to the HKCO in the West Kowloon Cultural District;
 - (b) the HKCO to review the terms and conditions of the employment contracts with artistic staff, having regard to the characteristics of the work of artistic staff and the need to allow flexibility to cater to the dynamics and complexity of orchestral music; and

- (c) the HKCO to issue guidelines on the granting of annual leave and time off for overtime work for compliance by its staff;

Other administrative issues

- does not accept that:
 - (a) in its 2009 exercise for selecting nominated suppliers, the HKCO invited only a small number of suppliers to provide quotations for certain types of common goods/services, resulting in that only one to two nominated suppliers were selected for each of these goods/services;
 - (b) there were no established tendering procedures;
 - (c) the HKCO did not maintain a proper record of the acquisition and disposals of 1,975 drums purchased for the first Drum Festival in 2003, and there were discrepancies between the physical stock (as at November 2009) and the HKCO records for 10 of 13 types of drums;
 - (d) the HKCO did not formulate a disposal plan for the drums which were excessive to its normal requirement, resulting in storage cost of \$617,000 and 623 drums being damaged before they could be disposed of by sale or donation; and
 - (e) there were cases of non-compliance with the established guidelines on entertainment expenses;
- acknowledges that the Council Chairman, HKCO has agreed with the recommendations mentioned in paragraphs 5.9, 5.18, 5.23 and 5.27 of the Audit Report;
- urges the HKCO to expeditiously implement the above Audit recommendations; and

Follow-up actions

- wishes to be kept informed of:
 - (a) the actions taken by the HAB to acquire the necessary expertise in arts administration so as to establish a set of qualitative and quantitative criteria for evaluating the proper needs of subvented performing arts groups, including the HKCO;
 - (b) the outcome of the consultancy study on funding for the performing arts;

- (c) the improved monitoring mechanism for performing arts groups formulated by the HAB;
- (d) the measures adopted by the HAB to ensure compliance by the HKCO and other performing arts groups with all the provisions in the FSA, including those which are outside the revised audit scope under the 2010-2011 FSA, e.g. clause 6(a) on internal controls, clause 6(h) on code of conduct (for Board members and staff) and declarations of conflict of interest, and clause 6(u) on procurement, with a view to ensuring proper management and control of public funding;
- (e) the actions taken by the HKCO to review its Corporate Governance Guidelines, Accounting PPM, Human Resources PPM, Marketing and Development PPM, and other relevant regulations and guidelines to ensure that they are in line with good governance and management principles while at the same time practicable, having regard to the nature and characteristics of the HKCO's work;
- (f) the actions taken by the HKCO to attract more people to become HKCO members as an avenue for bringing in more new ideas and expertise to the Council of the HKCO to help in its development;
- (g) the progress made by the HAB in facilitating the dissemination of information on the governance and management practices adopted by some performing arts group for reference by other arts groups;
- (h) the objective criteria devised by the HKCO for changing its regular concerts to private functions for commercial sponsors;
- (i) the HKCO's arrangements with schools and other suitable organisations to offer less favorable seats to them, instead of blocking a large number of such seats from ticket sales;
- (j) the HAB's measures to provide adequate support facilities, including space for rehearsals and self-practices and storage of musical instruments, to the HKCO;
- (k) the progress made by the HKCO in reviewing the terms and conditions of the employment contracts with artistic staff, having regard to the characteristics of the work of artistic staff and the need to allow flexibility to cater to the dynamics and complexity of orchestral music;
- (l) the HKCO's guidelines on the granting of annual leave and time off for overtime work; and
- (m) the progress made in implementing the various Audit recommendations.