

**REPORT OF THE
PUBLIC ACCOUNTS COMMITTEE
ON
REPORT NO. 56 OF THE DIRECTOR OF AUDIT
ON
THE RESULTS OF
VALUE FOR MONEY AUDITS**

July 2011

P.A.C. Report No. 56

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Procedure

The Committee's Procedure The practice and procedure, as determined by the Committee in accordance with Rule 72 of the Rules of Procedure, are as follows:

- (a) the public officers called before the Committee in accordance with Rule 72 of the Rules of Procedure, shall normally be the Controlling Officers of the Heads of Revenue or Expenditure to which the Director of Audit has referred in his Report except where the matter under consideration affects more than one such Head or involves a question of policy or of principle in which case the relevant Director of Bureau of the Government or other appropriate officers shall be called. Appearance before the Committee shall be a personal responsibility of the public officer called and whilst he may be accompanied by members of his staff to assist him with points of detail, the responsibility for the information or the production of records or documents required by the Committee shall rest with him alone;
- (b) where any matter referred to in the Director of Audit's Report on the accounts of the Government relates to the affairs of an organisation subvented by the Government, the person normally required to appear before the Committee shall be the Controlling Officer of the vote from which the relevant subvention has been paid, but the Committee shall not preclude the calling of a representative of the subvented body concerned where it is considered that such a representative could assist the Committee in its deliberations;
- (c) the Director of Audit and the Secretary for Financial Services and the Treasury shall be called upon to assist the Committee when Controlling Officers or other persons are providing information or explanations to the Committee;
- (d) the Committee shall take evidence from any parties outside the civil service and the subvented sector before making reference to them in a report;
- (e) the Committee shall not normally make recommendations on a case on the basis solely of the Director of Audit's presentation;
- (f) the Committee shall not allow written submissions from Controlling Officers other than as an adjunct to their personal appearance before the Committee; and

Procedure

- (g) the Committee shall hold informal consultations with the Director of Audit from time to time, so that the Committee could suggest fruitful areas for value for money study by the Director of Audit.

2. **Confidentiality Undertaking by Members of the Committee** To enhance the integrity of the Committee and its work, members of the Public Accounts Committee have signed a confidentiality undertaking. Members agree that, in relation to the consideration of the Director of Audit's reports, they will not disclose any matter relating to the proceedings of the Committee that is classified as confidential, which shall include any evidence or documents presented to the Committee, and any information on discussions or deliberations at its meetings, other than at meetings held in public. Members also agree to take the necessary steps to prevent disclosure of such matter either before or after the Committee presents its report to the Council, unless the confidential classification has been removed by the Committee.

3. A copy of the Confidentiality Undertakings signed by members of the Committee has been uploaded onto the Legislative Council website.

4. **The Committee's Report** This Report by the Public Accounts Committee corresponds with Report No. 56 of the Director of Audit on the results of value for money audits which was tabled in the Legislative Council on 13 April 2011. Value for money audits are conducted in accordance with the guidelines and procedures set out in the Paper on Scope of Government Audit in the Hong Kong Special Administrative Region - 'Value for Money Audits' which was tabled in the Provisional Legislative Council on 11 February 1998. A copy of the Paper is attached in *Appendix 2*.

5. **The Government's Response** The Government's response to the Committee's Report is contained in the Government Minute, which comments as appropriate on the Committee's conclusions and recommendations, indicates what action the Government proposes to take to rectify any irregularities which have been brought to notice by the Committee or by the Director of Audit and, if necessary, explains why it does not intend to take action. It is the Government's stated intention that the Government Minute should be laid on the table of the Legislative Council within three months of the laying of the Report of the Committee to which it relates.

Consideration of the Director of Audit's Report tabled in the Legislative Council on 13 April 2011 As in previous years, the Committee did not consider it necessary to investigate in detail every observation contained in the Director of Audit's Report. The Committee has therefore only selected those chapters in the Director of Audit's Report No. 56 which, in its view, referred to more serious irregularities or shortcomings. It is the investigation of those chapters which constitutes the bulk of this Report. The Committee has also sought and obtained information from the Administration on some of the issues raised in another chapter of the Director of Audit's Report No. 56. The Administration's response has been included in this Report.

2. **Meetings** The Committee held a total of nine meetings and four public hearings in respect of the subjects covered in this Report. During the public hearings, the Committee heard evidence from a total of 17 witnesses, including two Directors of Bureau and two Heads of Department. The names of the witnesses are listed in *Appendix 3* to this Report. A copy of the Chairman's introductory remarks at the first public hearing in respect of the Director of Audit's Report No. 56 on 5 May 2011 is in *Appendix 4*.

3. **Arrangement of the Report** The evidence of the witnesses who appeared before the Committee, and the Committee's specific conclusions and recommendations, based on the evidence and on its deliberations on the relevant chapters of the Director of Audit's Report, are set out in Chapters 1 and 3 of Part 4 below.

4. The audio record of the proceedings of the Committee's public hearings is available on the Legislative Council website for the public to listen to.

5. **Acknowledgements** The Committee wishes to record its appreciation of the cooperative approach adopted by all the persons who were invited to give evidence. In addition, the Committee is grateful for the assistance and constructive advice given by the Secretary for Financial Services and the Treasury, the Legal Adviser and the Clerk. The Committee also wishes to thank the Director of Audit for the objective and professional manner in which he completed his Report, and for the many services which he and his staff have rendered to the Committee throughout its deliberations.

A. Introduction

The Hong Kong 2009 East Asian Games ("2009 EAG"), held between 5 and 13 December 2009, was the first large-scale international multi-sports event ever held in Hong Kong. The Audit Commission ("Audit") conducted a review to examine the planning, organisation and implementation of the 2009 EAG. The review focused on the following areas:

- post-implementation review;
- operating cost and revenue;
- reduction in number of shooting competition events;
- conversion of squash courts into office accommodation;
- admission ticketing arrangements; and
- Audit survey.

2. The Committee held two public hearings on 5 and 7 May 2011 respectively to receive evidence on the findings and observations on this subject in the Director of Audit's Report ("Audit Report"). **Mr TSANG Tak-sing, Secretary for Home Affairs**, made an opening statement at the Committee's public hearing held on 5 May 2011. The full text of his statement is in *Appendix 5*.

B. Operating cost and revenue

Full direct cost of organising the event

3. In July 2003, the Finance Committee ("FC") of the Legislative Council ("LegCo") accepted in principle the financial implications of \$84 million for providing a government subsidy to meet the operating deficit for hosting the 2009 EAG (with a total operating budget of \$171 million), and agreed that Hong Kong should make a bid for hosting the event. In November 2003, the Sports Federation and Olympic Committee of Hong Kong, China ("SF&OC") won the bid for hosting the 2009 EAG. In January 2006, the FC approved a commitment of \$123 million under the Leisure and Cultural Services Department ("LCSD") to provide financial support for the organisation and implementation of the event.

4. According to paragraph 3.4 the Audit Report, the Administration had not ascertained the full cost implications of hosting the 2009 EAG. In the funding paper submitted to the FC in January 2006, the Administration estimated that the gross expenditure for organising and implementing the 2009 EAG would be \$240 million. As it transpired, the actual expenditure was \$291.1 million. In addition, as ascertained by Audit, apart from the expenditure financed by the government subsidy of \$123 million, additional direct expenditures amounting to \$132.8 million had been incurred by various bureaux/departments ("B/Ds") to support the hosting of the event. The B/Ds included the LCSD, the Home Affairs Bureau ("HAB"), the Information Services Department, the Home Affairs Department ("HAD") and the Architectural Services Department. However, the FC had not been informed of such additional expenditures.

5. Against the above background, the Committee asked whether the Administration agreed that the \$132.8 million incurred by various B/Ds to support the hosting of the 2009 EAG, as set out in Table 2 in paragraph 3.4 of the Audit Report, was direct expenditure of the Games and should be taken into account when calculating the full direct cost of the event.

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

- the bid to host the EAG was won in late 2003 and the event was staged in late 2009. The project spanned six years and involved two terms of the Hong Kong Special Administrative Region ("HKSAR") Government;
- back in 2003 when the SF&OC made a bid for hosting the EAG, the Hong Kong economy had yet to recover from the damage caused by the outbreak of the Severe Acute Respiratory Syndrome ("SARS"). As such, the Administration sought in-principle approval from the FC for an estimated government commitment of only \$84 million for staging the EAG. When the Administration sought funding support from the FC for the operating cost of the EAG in January 2006, the government commitment was revised to \$123 million because more details on the sports items to be held and the resources required had been confirmed by that time. The \$123 million was the upper limit of the government subsidy for supporting the hosting of the EAG. The current HKSAR Government had taken measures to ensure that the allocation of \$123 million approved by the FC for the EAG would not be exceeded.

The measures included economising on expenditure and generating revenue from various sources, such as sponsorship;

- apart from the direct expenditures of the EAG, different government departments, including the police, medical and health, and immigration, had also enhanced their services to support the hosting of the EAG. The additional costs incurred were absorbed by the departments concerned. These departments would provide assistance to support any major events held in Hong Kong as part of their day-to-day responsibilities. It would be impractical and unfair to require the Administration to differentiate those expenditures from the departments' votes and attribute them to the EAG; and
- in fact, in the course of preparing the 2009 EAG, the Hong Kong economy suffered another setback due to the financial tsunami. The Financial Secretary specially allocated funding in his 2009-2010 Budget to various B/Ds for boosting domestic demand and increasing job opportunities. The initiative was approved by the FC. A large proportion of the funding allocated to the HAB and the LCSD was spent on employing young people for handling EAG duties. The HAB did not regard such expenditures as direct expenditures of the EAG. They were only indirect expenditures and were financed by the B/Ds' recurrent funding which had been approved by the FC.

7. The Committee noted the view of the Secretary for Financial Services and the Treasury given in paragraph 3.28 of the Audit Report that the expenditures incurred by various B/Ds listed in Table 2 of the Audit Report, as part of the overall financial implications of hosting the EAG, were quite different from the direct expenditures, such as those incurred by the 2009 East Asian Games (Hong Kong) Limited ("EAG Company") in hosting the EAG. The Committee asked about the basis of the Secretary for Financial Services and the Treasury's view and requested the full text of the Secretary's response.

8. The **Secretary for Financial Services and the Treasury** provided, in his letter of 13 May 2011 in *Appendix 6*, the full text of his response to Audit as set out in paragraph 3.28 of the Audit Report.

9. The Committee further asked whether the Administration agreed that, in seeking the FC's acceptance in principle for making a bid and funding approval for

hosting a major event, it should inform the FC of the full cost implications of hosting the event, particularly the total direct costs, so as to enable the FC to make an informed decision.

10. **Mr Stanley YING, Permanent Secretary for Financial Services and the Treasury (Treasury)**, stated that:

- as a matter of principle, the Administration agreed that when seeking funding approval from the FC for making a bid and funding approval for implementing an event, it should set out the full direct cost involved. In fact, this had all along been the Administration's practice;
- in practice, however, whether a specific expenditure should be regarded as the direct expenditure of an event was a matter of judgement. Also, at the time of seeking approval from the FC, the Administration might not have information on all the expenditures that would be incurred in the future. For example, the LCSD was allocated a sum of \$24.7 million in 2009-2010 under the ad hoc job creation initiative and this was after the granting of funding approval by the FC in 2006 for hosting the EAG. Subsequently, the LCSD employed contract staff to support the EAG with the additional allocation. In the circumstances, the Administration did not consider that the expenditure for employing the contract staff concerned was a direct expenditure of the EAG because it was not the EAG's requirement to employ such staff;
- under the existing mechanism, B/Ds were provided with annual provisions approved by the FC for carrying out their regular duties and delivering public services. The departments would provide support to different activities held in Hong Kong with funding from their departmental votes. As the 2009 EAG was a large-scale event, many departments had strengthened their services to support the event by deploying their departmental resources, e.g. the Hong Kong Police Force, the Customs and Excise Department, the Immigration Department, and the Hongkong Post. The Hong Kong Tourism Board had also provided services for the 2009 EAG as part of its normal duties to promote Hong Kong. In the Administration's view, these expenditures should not be regarded as direct expenditures of the 2009 EAG; and

- including the cost of services provided by various B/Ds, which belonged to their regular day-to-day duties, as the direct cost of an event/project would be at variance with the Administration's established practice in public finance management. The Administration did not agree to such arrangement.

11. The Committee pointed out that the additional direct expenditures as ascertained by Audit did not include the expenditures incurred by the police and immigration staff, etc for supporting any major function held in Hong Kong. Instead, they included the cost of temporary staff and temporary works which were directly related to the 2009 EAG and hence should be regarded as its direct expenditures.

12. According to the Committee's calculations, the total expenditure of the 2009 EAG amounted to some \$423.9 million, i.e. the actual expenditure of \$291.1 million plus the additional direct expenditures of \$132.8 million incurred by various B/Ds. The total amount borne by the Government, including the additional direct expenditures, should be \$243.9 million (i.e. \$111.1 million plus \$132.8 million). The Committee invited Audit's views on its calculations.

13. **Mr Benjamin TANG, Director of Audit**, said that:

- he agreed to the Committee's calculation of the total expenditure of the 2009 EAG and the total amount borne by the Government; and
- the additional direct expenditures as set out in Table 2 of the Audit Report were incurred by various B/Ds in employing staff or performing duties specifically for the purpose of the 2009 EAG, and were therefore direct expenditures of the EAG. Audit agreed that other expenditures like those arising from strengthened manpower of the Hong Kong Police Force or the Immigration Department due to the hosting of the event, as mentioned by the Secretary for Home Affairs and the Permanent Secretary for Financial Services and the Treasury (Treasury) earlier, were indirect expenditures. Such expenditures had not been taken into account by Audit in calculating the full direct cost of the EAG.

14. **Mrs Betty FUNG, Director of Leisure and Cultural Services**, explained that:

- it was the LCSD's responsibilities to provide support for large-scale sports events held in Hong Kong, such as the Hong Kong Marathon held every year. The LCSD also hosted sports events on its own for the purpose of promoting the development of sports. The LCSD's venues would be used for supporting the events in these situations. As such, it was the LCSD's duty to support the staging of the 2009 EAG and different expenditure items had been incurred;
- of the \$132.8 million additional direct expenditures set out in Table 2 of the Audit Report, \$73.3 million was incurred by the LCSD. The sum included \$24.7 million which was allocated to the LCSD under the Financial Secretary's initiative in the 2009-2010 Budget for creating temporary jobs. In 2009-2010, the LCSD spent \$22.7 million on employing about 160 contract staff for arranging EAG activities. These contract staff were deployed to the EAG Company to work at the competition venues and perform reception duties, etc. In fact, such expenditure would not have been incurred without the additional provision because the LCSD would not allocate its own resources to the EAG Company for employing the 160 contract staff; and
- the remaining \$50 million was the expenditure which the LCSD should spend to fulfil its regular responsibilities of promoting the development of sports, fostering the sporting culture and providing venue support. Of the \$50 million, \$23 million was used to implement a number of activities under the theme of "Green, Cultural, Dynamic Games" and to publicise the 2009 EAG, including the Countdown Show, the Torch Relay and a series of city dress-up programmes. About \$26 million was used to create 80 time-limited civil service posts in the five years from 2006-2007 to 2010-2011 to perform EAG duties, including enhanced security at competition venues, coordination with the EAG Company, National Sports Associations ("NSAs") and other government departments, publicity and promotion, VIP hospitality and so on. The LCSD would have provided the same support services for other events as part of its day-to-day responsibilities. Most of the 80 posts were only created for two to six months before the commencement of the EAG and all the posts were filled by serving LCSD staff.

15. In response to the Committee's request, the **Secretary for Home Affairs** provided, in Annex A of his letter dated 24 May 2011 (in *Appendix 7*), a breakdown of the 80 government staff deployed by the LCSD from 2006-2007 to 2010-2011 to provide support for the 2009 EAG, including their ranks and monthly salaries.

16. The Committee noted that the LCSD had deployed its staff to fill the 80 posts on a full-time basis. In some cases, the duties originally handled by those staff had to be covered by acting appointment. The Committee considered such an arrangement different from the deployment of police officers to perform crowd control duty when there was a major event like a fireworks show. As the police officers only performed the duty for several hours occasionally, the expenditures so incurred by the Police were only indirect expenditures of the fireworks show. In the circumstance, the Committee asked:

- why the Director of Leisure and Cultural Services insisted that the expenditures incurred by the LCSD as set out in paragraph 3.5 of the Audit Report were not direct expenditures of the 2009 EAG; and
- about the source of funding for creating the 80 posts and the acting arrangement.

17. The **Director of Leisure and Cultural Services** further explained that:

- as a general principle, when a major event was held in Hong Kong, different government departments would have to allocate resources under their departmental votes to support the event. The EAG was closely related to the work of the LCSD because it was the department's regular duties to promote sports, culture and a green city. The LCSD only deployed slightly more resources during the EAG to perform such regular duties, using the EAG as a theme; and
- the LCSD was one of the largest departments in the HKSAR Government with more than 8,000 staff and an annual recurrent expenditure of some \$5 billion. Very often, there were vacant posts that could not be filled at different times of a year. When necessary, the saving from the vacant posts could be used to create temporary posts through internal deployment of resources. As more than 50% of the 80 posts only lasted for two months, they were created by such resource deployment without affecting the LCSD's regular duties and services.

18. Noting that the HAB had not prepared an estimate of acceptable accuracy of the income and expenditure for the 2009 EAG when it sought the LegCo's approval for hosting the event, the Committee asked:

- about the mechanism adopted by the Administration for preparing the budget for the 2009 EAG and ensuring its accuracy, given that the EAG was a major event the preparation and implementation of which straddled two terms of the LegCo and two terms of the HKSAR Government; and
- about the role played by the Financial Services and the Treasury Bureau ("FSTB") in ensuring the accuracy of the budget and whether there was any coordination between the HAB and the FSTB.

19. The Committee further asked whether the Secretary for Home Affairs accepted that in organising a major event, the HAB should include all the projected expenditures, both direct and indirect, in the budget so as to enable members of the public to know the total cost involved.

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

- in preparing the budget for the 2009 EAG, the HAB and the LCSD made suggestions and discussed with the FSTB;
- there was not a standard format for hosting a sports event and different places would have different standards for implementing major sports games. The Administration prepared the budget for the 2009 EAG having regard to the prevailing economic conditions and the affordability of the HKSAR Government at the relevant time. When the Administration prepared the budget in 2003 for seeking the FC's approval for bidding the hosting right, Hong Kong was suffering from the outbreak of the SARS. Hence, the assessment at that time was that the 2009 EAG should be organised in a modest manner. Having been granted the hosting right, the Administration studied the implementation of major sports games held elsewhere, particularly the 2005 Macau EAG, and sought the detailed advice of the sports sector. It then provided the FC with an updated budget in 2006 and sought the FC's approval for a government commitment of \$123 million;

- all the expenditures of the 2009 EAG were met by the provisions approved by the FC. There was no question of hidden expenditures of the EAG. For example, the HAB allocated funds from its departmental vote to carry out improvement works for the Tseung Kwan O Sports Ground. Although the improvement works were related to the 2009 EAG, the HAB did not carry out the works solely for the EAG, but for the long-term development of sports in Hong Kong; and
- the Administration had thoroughly considered the question as to whether all the expenditures incurred by various B/Ds in support of a major event, including those identified by Audit, should be regarded as part of the full cost of hosting the event. To do so, it would be necessary to quantify the amount of resources to be devoted by the B/Ds for inclusion in the budget of the event. The Administration considered such arrangement not advisable because it might give rise to an undesirable situation where B/Ds might be reluctant to undertake responsibilities which had not been budgeted for. This would create a negative impact on the delivery of public services.

21. The **Permanent Secretary for Financial Services and the Treasury (Treasury)** supplemented that:

- it was indeed the Administration's objective to prepare an accurate budget for a major event so that the authorities concerned would have a better understanding of the total cost involved when deciding whether to approve the hosting of the event. However, there were practical difficulties in providing an accurate budget because there would be a long time gap between making a decision to host a major event and actually launching it. A lot of changes would take place over the years. Moreover, the details of the event, such as the scale and the competition events to be held, would also be subject to change; and
- the Administration would draw on the experience gained from hosting each major event and, in organising similar events in future, strive to provide the LegCo with the most accurate estimate. However, the Administration could only prepare a budget based on the information available at the time of its preparation.

22. To ascertain the role of the Secretary for Home Affairs in the 2009 EAG, the Committee enquired:

- whether the Secretary for Home Affairs had discussed in detail the planning and preparation of the EAG with his predecessor when he assumed the post on 1 July 2007, given that the 2009 EAG was a highly important task during his term of office;
- as the Tripartite Agreement of June 2006 entered among the Government, the SF&OC and the EAG Company set out the detailed arrangements and the roles and responsibilities of the three parties in the organisation, implementation and delivery of the 2009 EAG, including the Government's cost control over the EAG, whether the Secretary for Home Affairs had read the Tripartite Agreement when he assumed office;
- whether the Secretary for Home Affairs had attended the meetings of the EAG Planning Committee and the Board of Directors of the EAG Company, which were important parts of the mechanism for overseeing the planning and preparation of the 2009 EAG; and
- whether the Secretary for Home Affairs had established a special reporting and monitoring mechanism in the HAB for the 2009 EAG, so as to enable him to have a full understanding of the operation and expenditures of the EAG.

23. The **Secretary for Home Affairs** replied that:

- according to normal government procedures, he had discussed the various aspects of his work with the former Secretary for Home Affairs. Apart from the 2009 EAG, he had other important tasks to deal with when he assumed the post, including the hosting of the Equestrian Events of the 2008 Beijing Olympics and Paralympics in Hong Kong. However, the continuity of the work of the Government did not rely on discussions at the personal level, but on file records and documents and civil servants like the permanent secretaries who would remain in office despite the change of bureau secretaries;
- he had not read the Tripartite Agreement when he assumed office, but he knew the main provisions therein. He was fully aware that the government commitment for the 2009 EAG was \$123 million and it was

necessary to take measures to ensure that this ceiling of subsidy would not be exceeded;

- he was not a member of the Board of Directors of the EAG Company, so he had not attended its meetings. He had also not attended the meetings of the EAG Planning Committee, but it would report important issues to him; and
- as directed by him, the EAG Organising Committee was established in 2008 to coordinate the work of various government departments and non-governmental agencies for the 2009 EAG. The Committee was co-chaired by the Chairman of the EAG Planning Committee and the Permanent Secretary for Home Affairs. Under this Committee, there were five coordinating committees overseeing five key functional areas. There were also standing reporting and monitoring mechanisms in place in the HAB for the different tasks within the bureau's purview. The Permanent Secretary and the Director of Leisure and Cultural Services would regularly report to him on their work, including the organisation of the 2009 EAG. As such, he had a full understanding of the implementation of the EAG.

24. The Committee further asked whether the Secretary for Home Affairs was involved in soliciting sponsorship for the 2009 EAG, and whether he had given any direction to maximise the amount of sponsorship so as to enable the EAG Company to have more surplus funding for return to the Government after the conclusion of the Games.

25. The **Secretary for Home Affairs** said that under the Tripartite Agreement, the EAG Company was responsible for fund raising, but he was informed of the progress in obtaining sponsorship. The goal of the Administration and the EAG Company was to solicit as much sponsorship as possible to support the EAG while ensuring that the government commitment of \$123 million would not be exceeded. In the end, this goal was achieved. The 2009 EAG was successfully held and the EAG Company was not only able to balance its books, it even recorded a surplus for return to the Government.

Income and expenditure variances

26. According to Table 3 in paragraph 3.14 of the Audit Report, some actual income and expenditure items of the 2009 EAG as at June 2010 differed significantly from the estimated amounts stated in the FC paper of January 2006. For example, the estimated and actual expenditures on the opening and closing ceremonies were \$35 million and \$63.4 million respectively (i.e. an increase of 81%). The amount of income from community/commercial sponsorship had also increased by 163%.

27. It appeared to the Committee that the significant variances between the estimated and actual income and expenditure items reflected that, in seeking the LegCo's support for hosting a major event, the Administration tended to be conservative in estimating the expenditure and over-optimistic in estimating the income. The Committee queried:

- whether this was the case and why there were significant variations in the income and expenditure items of the 2009 EAG; and
- why the HAB had not been able to provide a reasonably accurate budget for some expenditure items such as the cost of transportation, which should be under the Administration's control.

28. **The Secretary for Home Affairs and Mr Johnny WOO, Former Chief Executive Officer of the EAG Company**, responded that:

- as stated in the FC submission in 2006, the Government's objective was to ensure that the EAG Company would use its best endeavour to economise on expenditures, live within the sums appropriated by the FC and generate revenues for organising the EAG. The Administration considered that these objectives had been achieved in that the EAG Company had lived within the \$123 million approved by FC and attained a balanced final account with a surplus to be returned to the Government. The actual balance borne by the Government was only about \$110 million, or 38% of the total operating expenditure for the EAG; and
- as the 2009 EAG was a major international sports event and its preparation lasted some six years, it was not unusual to find variations between the estimated and actual income and expenditure in respect of individual items. The Administration was unable to give a very

accurate estimate of the income and expenditure involved before details of the Games were confirmed at a later stage of the preparation process.

29. The **Director of Leisure and Cultural Services** supplemented that:

- the budget included in the funding paper submitted to the FC in January 2006 was prepared in 2005. At that time, the Hong Kong economy had not yet fully recovered from the SARS. In preparing the budget, the LCSD had consulted the sports sector, including the SF&OC, particularly on the amount of community sponsorship that such sports events would be able to attract. As a matter of fact, the estimated income from sponsorship had already been revised from \$30 million in 2003 to \$50 million in 2006. But given the economic situation at that time, the LCSD was not confident that it could solicit an even greater amount of sponsorship, e.g. up to \$100 million. As it transpired, the Hong Kong economy recovered in 2008 and 2009 and the society began to show more support for sports and athletes. The EAG Company was then able to solicit a total sponsorship of \$131.4 million through the SF&OC and other sources;
- the decrease in ticket sales was due to the setting of a lower ticket price at the time of sale (\$50 on average) than the original estimate (\$100 on average). The adjustment was made in response to FC members' views that the ticket price should be low to encourage people to watch the EAG competition events; and
- some variations were due to changes in the accounts to be charged for certain expenditure items. For example, the increase in expenditure on accommodation and catering was due to the redirection of accommodation and catering costs of VIPs from “VIP hospitality” to this item. The increase in transportation expenditure was due mainly to the redirection of the transportation cost for VIPs from “VIP hospitality” to this item.

30. The Committee further asked why the expenditure on the opening and closing ceremonies had increased by 81%, and whether this reflected that the HAB and the LCSD had not properly performed their duty of ensuring that the EAG Company would keep its expenditures within budget.

31. The **Director of Leisure and Cultural Services** and the **Former Chief Executive Officer of the EAG Company** responded that:

- the expenditure on the opening and closing ceremonies had increased due to the improved standard and quality of the opening ceremony. The closing ceremony only cost about \$3 million. After the 2008 Beijing Olympics, the public had a higher expectation on the scale and standard of the opening ceremony of a major multi-sports event like the EAG;
- the HAB and the LCSD worked closely with the EAG Company and urged the company to adopt a prudent approach in financial management and to keep its expenditures within budget. Before making a commitment to increase an expenditure item, the EAG Company was required to first identify additional funds, such as a sponsorship, for the purpose; and
- as a result of the EAG Company's efforts to generate revenue, the company received a sponsorship of \$10 million from Sponsor A in November 2009 to support the opening ceremony. Given this sponsorship, the EAG Company managed to engage the production team of the 2008 Olympic Games Opening Ceremony for the EAG and produced a remarkable opening ceremony.

32. The **Secretary for Home Affairs** stated that it was his decision to hold a remarkable EAG opening ceremony for the 2009 EAG after knowing that there would be sufficient funding for the purpose.

33. Regarding the income from television rights, the Committee noted that when the Administration sought in-principle support from the FC for hosting the EAG in July 2003, the estimated revenue from television rights was \$25 million. In the FC paper of January 2006, the estimate was revised downwards to \$12 million. In the end, the actual income as at June 2010 was only \$1.2 million, representing a decrease of 90% from the 2006 estimate. The Committee queried about the reasons for the significant variance in this regard and whether the Administration had intentionally over-estimated this income item in order to obtain support from the FC.

34. The **Director of Leisure and Cultural Services** stated that the variance was mainly caused by the Administration's lack of experience in devising the original estimated income from the sale of broadcasting and television rights.

35. **Miss Olivia CHAN, Assistant Director (Leisure Services) 2 of the LCSD**, stated at the public hearings, and the **Secretary for Home Affairs** stated in his letter of 24 May 2011, that:

- when the Administration sought the FC's in-principle support in July 2003 for Hong Kong to bid for the right to host the 2009 EAG, it assumed that there would be bids for the host broadcasting rights and that the income so derived would be in the region of \$25 million. Subsequently, in view of the experience of the 2005 EAG held in Macau, the Administration adjusted the estimated income from the sale of broadcasting rights downwards to \$12 million when seeking the FC's funding approval in January 2006. However, the experience of the Hong Kong leg of the 2008 Beijing Olympic Torch Relay revealed that none of the local electronic media organisations had the required capacity to take up the role of host broadcaster for the Torch Relay. To overcome such problem, a consortium involving all the local electronic media organisations was formed to share the filming work at cost and, in return, they were granted free broadcasting rights for the Torch Relay;
- taking into account the arrangements for the Olympic Torch Relay and in view of the large number of EAG venues and competition events to be covered, the EAG Company and the local electronic media organisations agreed in early 2009 that a consortium should be formed to arrange for the filming and broadcasting of the 2009 EAG; and
- the seven local electronic media organisations agreed among themselves the division of production work for the EAG ceremonies and competitions, having regard to manpower and equipment availability. Under the consortium model, the local electronic media organisations were required to provide production crews, equipment and coverage of the EAG ceremonies and competition events at cost and, in return, were granted free broadcasting rights. As for overseas broadcasters, the EAG Company engaged an acquisition agent through open tender to handle the sales and distribution of the broadcasting rights. After deducting the commission paid to the agent, the EAG Company received \$1.2 million from the sale of broadcasting rights to 16 overseas broadcasters.

36. Noting that the estimated and actual amounts of "Other income" were \$4 million and \$26.1 million respectively, representing an increase of 553%, the Committee asked for a breakdown of "Other income" and the reasons for the significant increase.

37. The **Former Chief Executive Officer of the EAG Company** stated that "Other income" included admission fees of the two EAG fund-raising concerts and the increase was mainly due to the excellent response to the concerts which raised some \$20 million. In his letter of 24 May 2011, the **Secretary for Home Affairs** provided a breakdown of the \$26.1 million under "Other income", as follows:

(a) EAG fund-raising concerts	\$19.75 million
(b) Income from pro-shop, banner promotion and video wall promotion services, EAG stamps and magazine, bank interest and sundry items	\$6.33 million
Total	\$26.08 million

38. In response to the Committee's request, the **Secretary for Home Affairs** provided, in Annex C of his letter of 24 May 2011, an analysis of the reasons for the significant variances between the estimated income and expenditure items and the actual ones, as set out in Table 3 in paragraph 3.14 of the Audit Report.

Post- implementation review

39. According to paragraph 2.2 of the Audit Report, the HAB, the LCSD and the EAG Company held a wash-up meeting on 15 December 2009 to review the experience of the 2009 EAG. Given that the 2009 EAG was the first large-scale international multi-sports event ever held in Hong Kong and there were significant variances between the estimated and actual income and expenditure items, the Committee asked whether:

- the parties concerned had discussed the reasons for the variances at the wash-up meeting;

- the Administration had conducted a comprehensive and systematic post-implementation review ("PIR") on the organisation of the 2009 EAG, including a financial review, so as to consolidate experience and enhance the Administration's capabilities for organising future events and preparing more accurate budgets; and
- the FSTB had promulgated any requirements for B/Ds to review the accuracy of the income and expenditure estimates for the major event hosted by them, after conclusion of the event.

40. The **Permanent Secretary for Financial Services and the Treasury (Treasury)** responded that:

- under the Public Finance Ordinance (Cap. 2), a controlling officer was responsible and accountable for all expenditure from any head or subhead for which he/she was the controlling officer. As far as the 2009 EAG was concerned, the Director of Leisure and Cultural Services was the controlling officer for the government commitment of \$123 million. There were other controlling officers for other funds relating to the hosting of the EAG, such as the expenditures on temporary works funded under the Capital Works Reserve Fund ("CWRF"); and
- at the central level, as mentioned in the Audit Report, the Efficiency Unit ("EU") had issued a best practice guide entitled "A User Guide to Post Implementation Reviews" ("the Guide") in February 2009 for reference by B/Ds.

41. The **Director of Leisure and Cultural Services** and the **Assistant Director (Leisure Services) 2** stated that:

- the wash-up meeting was held several days after the conclusion of the 2009 EAG. It focused on reviewing the experience gained in the operational aspect, and did not touch on financial issues; and
- the financial statements in relation to the last three months of the EAG Company's operation (i.e. from April to June 2010) had been completed in early April 2011 and submitted to the Inland Revenue Department ("IRD") for tax assessment. After obtaining a notice of clearance from

the IRD, the LCSD would have information on the final account of the EAG Company.

42. The **Secretary for Home Affairs** added that he had requested the relevant parties involved in the organisation of the 2009 EAG to conduct a review of the event and he had been provided with explanations for the variations in the income and expenditure items. Nevertheless, he agreed that there was room for improvement in this aspect and would consider the need to conduct a comprehensive financial review on the EAG.

43. The Committee enquired whether the review requested by the Secretary for Home Affairs had made reference to the user guide on PIRs issued by the EU. The **Secretary for Home Affairs** said that:

- as project planning for the 2009 EAG was already well advanced by the time the EU's guidance was available in February 2009, the Administration could not fully follow the procedures for a formal PIR as laid down in the EU's Guide. As a matter of fact, the Guide did not specify a single format for conducting PIRs for compliance by all B/Ds, but set out the factors to be considered in conducting PIRs and the stages involved, etc for their reference; and
- in requesting the review of the 2009 EAG, he had focused on the experience gained from the Games for the purpose of promoting sports development in Hong Kong and for organising similar events in future, such as bidding for the right to host the Asian Games. He had highlighted some of the lessons learnt in his opening statement.

Cost of temporary works

44. As reported in paragraphs 3.8 and 3.10 of the Audit Report, the Administration informed the Panel on Home Affairs of the LegCo in July 2003 that the estimated cost of temporary works for the EAG venues was \$6.2 million. As it turned out, the actual cost of the temporary works amounted to \$48.2 million, representing a sixfold increase. Besides, the cost of temporary works was not included in the FC paper of January 2006 which sought funding approval for hosting the 2009 EAG.

45. Paragraph 3.11 of the Audit Report further revealed that, in seeking funding of \$823.6 million from the FC in 2007 for both the long-term improvement works for the government venues and the temporary works for the 2009 EAG, the Administration did not inform the FC of the estimated cost of the temporary works as a separate item.

46. The Committee asked:

- about the reasons for the significant increase in the cost of temporary works;
- why, despite that the temporary works were directly related to the 2009 EAG, the Administration did not include the cost of such works in the FC paper of 2006, thereby making it difficult for FC members to have the full picture of the total cost involved when considering whether to support the hosting of event; and
- why the Administration did not inform the FC of the cost of temporary works as a separate item in 2007.

47. The **Director of Leisure and Cultural Services** explained that:

- it was not possible for the Administration to provide an accurate estimate of the cost of the temporary works involved at the time of seeking acceptance in principle from the FC in 2003, as the sports items to be included and the venues to be used had to be approved by the EAG Association. Such approval would only be given after Hong Kong had succeeded in bidding for the EAG and submitted a list of sports items and venues for approval. These occurred in November 2003 and June 2006 respectively, after the FC had given its acceptance in principle in July 2003;
- it was the Administration's decision at that time to fund the temporary works under the CWRP and not to include the cost as the EAG's operating expenditure. In seeking the FC's funding approval for the government commitment of \$123 million in January 2006, the Administration had informed the FC that it would separately submit to the FC funding applications for the capital cost of venue improvement works of 13 government venues. In January and February 2007, the Administration submitted two papers respectively to the FC seeking

approval for a total funding of \$823.6 million under the CWRP for venue improvement works of the 13 government venues. The works included both the long-term improvement works and the temporary works for the 2009 EAG; and

- the Administration accepted Audit's recommendation that, in organising similar events in future, the cost information on temporary works should be presented as a separate item in the relevant FC papers. Drawing on the experience gained from the 2009 EAG, the estimated project cost for temporary overlay was listed as a separate item by the HAB in the public consultation document issued in 2010 for the bid for hosting the 2023 Asian Games.

Legacy project and use of public funds

Using surplus funding from the EAG to implement the legacy project

48. According to paragraphs 3.16 and 3.17 of the Audit Report, as of March 2010, the EAG Company had a surplus of \$21.5 million. In June 2010, under a legacy project of \$10 million, the EAG Company made two donations of \$4.9 million each, one to an athletes career and education programme and another to an athletes' fund, to support the long-term development of Hong Kong athletes. As reported in paragraph 3.19, Audit was concerned with the use of the EAG Company's surplus to finance the two donations because:

- according to the Tripartite Agreement of June 2006, the EAG Company should use all revenue generated solely for the organisation, implementation and delivery of the 2009 EAG, and any surplus funding should be returned to the Government; and
- neither the FC paper of January 2006 nor the Tripartite Agreement stated that the EAG Company would make donations to support the long-term development of Hong Kong athletes.

49. To ascertain the conditions on the disposal of surplus from the 2009 EAG, the Committee obtained a copy of the Tripartite Agreement (in **Appendix 8**) and the Memorandum and Articles of Association of the EAG Company (in **Appendix 9**). The Committee noted that Clause 16 of the Tripartite Agreement provided that "surplus funding from the Games, if any, up to the total amount of Government

subsidy provided and hiring charges waived, shall be returned to the Government". However, the meaning of "surplus funding" was not defined.

50. It appeared to the Committee that although the implementation of a legacy project to support the long-term development of Hong Kong athletes was a meaningful initiative on its own, the Tripartite Agreement did not allow the use of the EAG Company's operating surplus for such purpose. Moreover, according to the approval granted by the FC in 2006, the government commitment of \$123 million was to provide financial support for "the organisation and implementation" of the EAG, and the donations under the legacy project fell outside the ambit of the FC's approval.

51. Against the above background, the Committee asked:

- whether there was any provision in the Tripartite Agreement that allowed the Administration to use the EAG Company's operating surplus to finance the two donations under the legacy project; if there was no such provision, why the Administration considered it appropriate to expend the surplus in this way; and
- the Administration's justifications for not returning the \$10 million for financing the legacy project, which formed part of the EAG Company's surplus funding, to the Government in accordance with the Tripartite Agreement.

52. The **Director of Leisure and Cultural Services** stated that:

- in April 2010, the EAG Company informed the LCSD that it would have an unallocated balance of about \$20 million and consulted the LCSD on the disposal of the surplus. The EAG Company considered that it would be more meaningful to use the surplus, as a part of the EAG legacy, to support the career development and the living of both serving and retired athletes. This would also meet the public sentiment that the outstanding results of the 2009 EAG could not have been achieved without the contribution by local athletes; and
- in the view of the HAB and the LCSD, although there was not a specific provision in the Tripartite Agreement which stated that the EAG Company's operating surplus could be used for financing a legacy

project, there was also no provision in the agreement that prohibited such use. Hence, the LCSD, after obtaining the Secretary for Home Affairs' approval in May 2010, consulted the FSTB on the proposed legacy project. The FSTB advised in June 2010 that if part of the unallocated balance of \$20 million could be differentiated from the government subsidy and did not have any specified use, it could be argued that the Government might not have the first claim on that part of the balance.

53. The **Permanent Secretary for Financial Services and the Treasury (Treasury)** stated that:

- when the FSTB discussed with the LCSD the proposal to fund a legacy project by using an unallocated balance left in the EAG Company's account, the FSTB was mindful of the ambit of the FC's funding approval as set out in the FC paper of 2006;
- it was stated in paragraph 18 of the paper that "Surplus funding from the event, if any, up to the amount of government subsidy provided and hiring charges waived, shall be returned to the Government". Clause 16 of the Tripartite Agreement mirrored this requirement. The FSTB considered that under this funding condition, if a sponsored sum had not yet been deposited to the EAG Company's general pool of resources and if it was the donor's wish that the sponsorship should not be transferred to the Government, the EAG Company could consider respecting the donor's wish and spend the sponsored sums in such ways as deemed appropriate; and
- the FSTB did not have details of individual donations for the 2009 EAG, but it had explained the above principles to the LCSD.

54. **Hon Timothy FOK Tsun-ting, President of the SF&OC**, stated that the appropriation of the EAG Company's surplus to implement a legacy project was legitimate and reasonable. The arrangement was also in line with the wish of the sponsors and supported by the public. The EAG Company had sought advice from its legal adviser and the relevant government departments before making the decision. It was the Government's advice that half of the surplus should be returned to the General Revenue and the remainder could be donated to the athletes' funds.

55. As requested by the Committee, the **Secretary for Home Affairs** provided, in his letter of 6 May 2011 (in *Appendix 10*), an e-mail dated 23 April 2010 from the EAG Company's legal adviser setting out her opinion on the proposal of donating the company's surplus to the athletes' funds. In reply to the Committee's question, the **Permanent Secretary for Financial Services and the Treasury (Treasury)** confirmed that the Administration had not separately sought legal advice on the matter.

56. The Committee noted the legal adviser's view that "the EAG Company is bound by the Tripartite Agreement to use the funding for the Games and to refund the surplus to the Government. Such 'surplus' is in a sense a liability of the Company owed to the Government as a creditor. If however, the Government waives or concludes that the Company is not required to pay such 'surplus' to the Government, the Company may transfer the surplus in accordance with Clause 7 of the Memorandum". The Committee asked:

- about the procedure that the Secretary for Home Affairs had gone through before deciding to allow the EAG Company to use its surplus to fund the legacy project, instead of returning the surplus to the General Revenue; and
- whether it had occurred to the Secretary for Home Affairs that under the established regime for controlling the use of public funds, he should first seek the FC's approval for using the EAG Company's surplus to fund the legacy project, given that the legacy project fell outside the ambit of the FC's funding approval which was only for the organisation and implementation of the 2009 EAG.

57. The **Secretary for Home Affairs** replied that:

- he was aware that the Tripartite Agreement did not mention any legacy project and the operating surplus should be returned to the Government pursuant to the agreement. On the other hand, the EAG Company's legal adviser had confirmed that donations to funds that would benefit athletes fell within the company's objects stated in its Memorandum and Articles of Association;
- the LCSD had submitted a minute (a copy of the minutes is given in the Secretary for Home Affairs' letter of 31 May 2011 in *Appendix 11*) to him in early May 2010 seeking his decision on how to dispose of the surplus of the EAG Company in a proper and meaningful manner; and

- when the FC's funding approval was sought in January 2006, the Administration had not anticipated that there would be surplus from organising the EAG. The EAG Company eventually received a large amount of sponsorships and it was clearly the sponsors' wish that their donations should be used to support the EAG and sports development. In late 2009, the EAG Company identified a sponsorship which had not been spent and could be used for the purpose of the legacy project. He agreed that it would be desirable to implement projects which could benefit athletes and such arrangement would meet the public expectation. Taking all these into consideration, he made a policy decision to donate about \$10 million to support the long-term development of Hong Kong athletes. According to established practice, the decision was within the scope of policy decisions which he was entitled to make and it had not occurred to him that it was necessary for the Administration to seek the LegCo's approval.

58. In Annex D of his letter of 24 May 2011, the **Secretary for Home Affairs** provided a table showing the sequence of events for the arrangements for funding the legacy project and the relevant documents, including the correspondences between the FSTB and the LCSD. It was also stated in the letter that with the approval of the Secretary for Home Affairs and its Board of Directors, the EAG Company implemented the legacy project with a \$10 million sponsorship from Sponsor B, not Sponsor A (as stated in paragraph 3.17 of the Audit Report).

Source of finance for the legacy project

59. In view of the Secretary for Home Affairs' claim that the source of finance for the legacy project was a \$10 million sponsorship received from Sponsor B in January 2010, instead of the \$10 million sponsorship from Sponsor A in November 2009, the Committee asked about the basis of the Secretary's claim and the details of Sponsor B's donation, including the conditions and timing of the donation.

60. The **Secretary for Home Affairs** responded in his letters of 24 May 2011 and 31 May 2011 that:

- the last batch of government funding disbursed to the EAG Company was received in November 2009. The \$10 million sponsorship used to fund the legacy project was received from Sponsor B in January 2010 and its purpose was to support the EAG generally without being

designated for any specific EAG activities or expenditure items. Given its timing, Sponsor B's \$10 million sponsorship could easily be differentiated from the government funding disbursed to the EAG Company;

- funding the legacy project with the above sponsorship met the general principles set out in the FSTB's memo dated 1 June 2010 (an extract from the memo is in Appendix V to Annex D of the Secretary's letter of 24 May 2011, in *Appendix 7*) and had suitably taken into account the wishes of the Sponsor to support the EAG and sports development. The EAG Company therefore sought its Board's approval in mid-June 2010; and
- Sponsor B made two major donations to the EAG Company. The first one, amounting to about \$13 million, was pledged in early 2009 for specific EAG activities. The second one, amounting to \$10 million, was pledged in November 2009 without reference to any designated use. The second donation did not form a part of nor was it in any way related to the first one. The payment of the second donation was eventually received on 22 January 2010.

61. The Committee invited Audit's comments on the new piece of information concerning the source of finance for the legacy project and whether it would affect Audit's observations and recommendations in this regard. In his letter of 30 May 2011 (in *Appendix 12*), the **Director of Audit** stated that:

- the new piece of information provided by the Secretary for Home Affairs did not affect Audit's observations and recommendations regarding the legacy project. Audit's views stated in paragraphs 3.19 and 3.26(d) of the Audit Report were still valid;
- Audit made reference to Sponsor A's \$10 million sponsorship in the Audit Report based on the following information:
 - (a) the minute submitted by the LCSD to the Secretary for Home Affairs on 5 May 2010 on the disposal of the surplus fund, specifying the proposed legacy project and an alternative option of returning to Sponsor A his sponsorship of \$10 million in support of the EAG opening ceremony; and

(b) the reference to Sponsor A's \$10 million sponsorship secured in November 2009 for enhancing the EAG opening ceremony in the correspondences in May and June 2010 between the LCSD and the FSTB; and

- during the course of the audit review, Audit could not find records showing that the legacy project was financed by Sponsor B's sponsorship, and neither the HAB nor the LCSD had provided Audit with such information.

62. In view of Audit's comments, the Committee asked the reason why:

- only the sponsorship from Sponsor A was discussed in the correspondences on the legacy project in May and June 2010 and there was no mention of the donation of \$10 million from Sponsor B at that time; and
- the Administration had not informed Audit that the legacy project was financed by Sponsor B's sponsorship, instead of Sponsor A's sponsorship, in the course of the audit review.

63. In his letter of 31 May 2011, the **Secretary for Home Affairs** explained that:

- in May 2010, the LCSD wrote to the FSTB to propose that the EAG Company should be allowed to use its unallocated balance to fund two legacy projects. In response to an oral enquiry from the FSTB, the LCSD replied via an email that the company had received some substantial "last-minute" donations, including the \$10 million donation from Sponsor A for enhancing the opening ceremony. This was cited as an example of a substantial "last-minute" donation secured by the company, in support of the LCSD's point that a large proportion of the unallocated balance was attributable to such donations. The LCSD did not give the FSTB an exhaustive list of the last-minute donations received by the company;
- the reference to Sponsor A in the reply from the FSTB to the LCSD was made to help illustrate the general principles that: "if all (or part) of the unallocated balance of \$20 million can be attributed to community/commercial sponsorship received by the EAG Company,

depending on the sponsorship terms, one could argue that the Government may not necessarily have the first claim on the balance (or that part of it)". The LCSD and the FSTB did not discuss the specific source of the funding that was proposed for implementing the legacy projects;

- the Administration's discussion with Audit on this area of the draft Audit Report focused primarily on the rationale for allowing the EAG Company to use part of the unallocated balance on the two legacy projects; and on whether such use was permissible under the Tripartite Agreement. In February 2011, the former Chief Executive Officer of the EAG Company pointed out to Audit that the donation from Sponsor A had been used to enhance the opening ceremony. Neither the LCSD nor the Chief Executive Officer were asked to clarify further the specific source of funding for the legacy projects; and
- as Audit's value-for-money study was conducted more than a year after the EAG was held, the EAG Company had ceased operation and no longer had any working staff. It was therefore not always possible for the Administration, which was not directly responsible for organising the EAG, to provide detailed facts and figures within a tight timeframe and to trace the reasons behind some of the decisions taken by the company. In these circumstances, it was possible that comments given by the LCSD did not cover in full each and every aspect of the various issues raised by Audit.

64. On the timing of Audit's value-for-money study, the **Director of Audit** clarified in his letter of 1 June 2011 (in **Appendix 13**) that Audit actually commenced the audit review in early August 2010, about seven months after the completion of the 2009 EAG in mid-December 2009. The audit was conducted shortly after the commencement of the liquidation of the EAG Company in June 2010.

Accounting arrangements for recognition of sponsorships and government grant

65. The Committee referred to Note 15 on "Deferred Income" in the Notes on the EAG Company's audited financial statements up to 31 March 2010 (in **Appendix 14**). As shown in the movements in the accounts during the years, in the 2010, all government grant had been expended and all the balance of \$23.8 million was regarded as sponsorships. However, the situation was different in 2009 where the balance included a large amount of government subsidy. The

Committee asked why different accounting treatments were adopted for the recognition of sponsorships and government grant in the two years, and whether the arrangements reflected the decision to attribute the EAG Company's balance to sponsorships instead of government grant, so that it would not form part of the surplus for return to the Government and could be used for other purposes, such as financing the legacy project.

66. The **Director of Leisure and Cultural Services** responded that the financial statements were prepared by professional accountants independently without being influenced by the EAG Company or the decision to implement the legacy project.

67. In Annex B of his letter of 24 May 2011, the **Secretary for Home Affairs** informed the Committee of the detailed accounting arrangements of the EAG Company for recognition of sponsorships and government grant. He also stated that the accounting treatments in this respect reflected the progress in delivering the EAG as well as the EAG Company's accounting policy and the actual funding situation. The accounting arrangement had been consistently applied throughout the financial years concerned. All deferred income from both government grant and sponsorships was recognised upon the conclusion of the 2009 EAG.

C. Other matters

Admission ticketing arrangements

68. According to paragraphs 6.9 and 6.10 of the Audit Report, on 2 December 2009, the first day of the preliminaries for some competition events, the EAG Company set up box offices for selling same-day admission tickets at three competition venues. It was only upon public requests that the EAG Company provided box offices at four additional competition venues for selling same-day tickets from the second day of the competition events. The Committee queried why sufficient on-site box offices were not provided from the first day of the events, which was not conducive to encouraging spectator attendance at the events.

69. The Committee was also aware of the comments that there were many unoccupied seats despite high ticket-sale rates, and asked whether the LCSD had analysed the causes thereof.

70. The **Director of Leisure and Cultural Services** replied that:

- box offices for selling on-site tickets were only available at some large LCSD venues, such as the Hong Kong Coliseum, the Hong Kong Stadium and the Queen Elizabeth Stadium. Many of the EAG competition events were held in smaller stadiums which did not have such facilities. Before the commencement of the EAG, the LCSD had enquired if the EAG Company would allocate more resources to establish on-site box offices at four other venues which still had unsold tickets. However, in view of the high set-up cost involved and the small number of tickets left for sale on-site, the EAG Company decided to set up on-site box offices at three competition venues only;
- on 2 December 2009, the LCSD was aware that there was public demand for improving the on-site ticket sales service. To meet the need of the public and visitors, four additional sales outlets were arranged on 3 December 2009 on top of the original three. This was made possible by an expedient arrangement agreed between the LCSD and the EAG Company whereby pre-printed tickets were sold on a cash basis; and
- the LCSD had reviewed the reason for having many unoccupied seats despite high ticket-sale rates. The EAG Company adopted a day-pass arrangement which enabled a holder to watch the events held at a competition venue at different times of a day. While this provided convenience to the pass holders, most of the holders might choose to attend those events held after office hours, leading to lower attendance rates for the events held in the daytime. The LCSD would explore ways to improve the ticketing arrangement in future, such as adopting a session-ticketing arrangement for appropriate sports items.

71. On the distribution of spectator seats, the Committee noted from Table 4 in paragraph 6.4 of the Audit Report that the total number of seats available for the opening and closing ceremonies and the competition events was about 413,000, but only 210,000 seats were available for open ticket sales after deducting the reserved seats, seats for guests with admission tickets and seats for sponsored student tickets. The Committee asked the purpose of assigning more than 33,000 reserved seats.

72. Paragraph 6.12 of the Audit Report also revealed that the overall attendance rates of some sports events for which a large number of admission tickets were issued to guests were very low. As low attendance rates of guests issued with admission tickets would result in a large number of unoccupied seats and effectively deprived other citizens of their opportunities to attend the competition events, the Committee asked why as many as 44,974 guest tickets were issued, and whether the LCSD had drawn on its own experience in distributing the free guest admission tickets.

73. The **Director of Leisure and Cultural Services** and the **Assistant Director (Leisure Services) 2** responded that:

- the 33,000 seats were reserved for operational use, including the placing of broadcasting equipment, and for use by the press and working personnel, etc. Besides, some seats were not released for sale due to their unsatisfactory location which would limit the spectators' view;
- the guest admission tickets were mainly issued to sponsoring organisations according to their sponsored amounts. Some were issued to District Councils, NSAs and the National Olympic Committees. For the cultural activities organised by the LCSD, the complimentary tickets were issued by the department directly and it could make arrangements to ensure the attendance of the recipients. For the EAG, the guest admission tickets were issued to the sponsors who, in turn, might give the tickets to their clients, staff or guests. The LCSD and the EAG Company did not have control over the distribution of tickets by the sponsors. Even the sponsors could not ensure the attendance of their guests;
- there were practical difficulties if the EAG Company did not reserve seats for guests issued with admission tickets. However, the LCSD and the EAG Company had promptly taken measures to address the situation after gaining experience from the competition events held earlier. For the events held in larger venues, such as the Siu Sai Wan Sports Ground, if there were still unoccupied seats reserved for guests after the events had started, the EAG Company would arrange for other spectators to take up those seats; and
- the LCSD agreed that it should explore ways to improve the arrangement for issuing guests tickets to sponsors when staging similar events in future.

74. In response to the Committee's question, the **Secretary for Home Affairs** stated in his letter of 24 May 2011 that, of the 44,974 admission tickets issued to all guests for the 22 sports events, about 18% of the tickets were issued to District Councils.

Conversion of squash courts into office accommodation

75. The Committee noted that the Administration informed the FC in January 2006 that the office accommodation of the EAG Company would be provided by conversion of six squash courts at the Hong Kong Squash Centre ("HKSC") and that the conversion and subsequent reinstatement of the squash courts would cost \$4.4 million. After completion of the conversion works at the HKSC at a cost of \$4.9 million, the EAG Company used the office accommodation from February 2007 to June 2010.

76. Paragraph 5.11 of the Audit Report, however, revealed that the Administration did not inform the FC of an alternative option of renting a private office in nearby areas and the related cost comparison information when seeking funding for the 2009 EAG in January 2006. In addition, as stated in paragraph 5.12, the LCSD did not take action to reinstate the six squash courts at the HKSC after they had been returned to the LCSD in June 2010. This was at variance with the commitment made to the FC in January 2006.

77. In response to the Committee's question, the **Director of Leisure and Cultural Services** confirmed that the Administration was aware of the need to avoid using sports facilities for permanent office purposes. The HAB and the LCSD would reconsider the future use of the converted squash courts at the HKSC, taking into account factors such as the cost of further works and the demand for sports facilities.

D. Conclusions and recommendations

78. The Committee:

Overall comments

- notes that the Audit Commission ("Audit")'s value for money review was focused on the planning, organisation and implementation of the

Hong Kong 2009 East Asian Games ("2009 EAG"), and not whether the Games had been held successfully;

- considers that it is incumbent upon the Administration, in seeking the Finance Committee ("FC")'s acceptance in principle for making a bid and funding approval for hosting a major event, to inform the FC of the full cost implications, particularly the full direct costs, of hosting the event. To this end, the Administration should:
 - (a) provide the FC with a comprehensive and reasonably accurate budget for the income and expenditure of the event, which should include all the direct expenditures to be incurred by various bureaux/departments ("B/Ds") to support the staging of the event;
 - (b) ensure that the budget also includes the costs of all necessary temporary improvement works of government venues and present such cost information in the FC papers as a separate item;
 - (c) use its best endeavour to provide an estimation of the indirect expenditures involved when seeking the FC's in-principle support for the event; and
 - (d) inform the FC of the revised estimates after more details of the event have been confirmed, such as when applying for the FC's funding approval upon successful bidding for the event;
- recommends that the Secretary for Financial Services and the Treasury:
 - (a) should widely promulgate the above requirements for compliance by B/Ds when preparing papers for the FC, and take measures to ensure compliance; and
 - (b) for those major events/projects which take years to prepare and implement, should establish a mechanism to require the responsible B/Ds to proactively keep the Legislative Council ("LegCo") informed of the updated income and expenditure estimates and highlight significant changes since such estimates were provided to the FC, such as by making periodic progress reports to the relevant Panels or the FC where appropriate;
- expresses dissatisfaction and finds that the Tripartite Agreement of June 2006 entered among the Government, the Sports Federation and

Olympic Committee of Hong Kong, China and the 2009 East Asian Games (Hong Kong) Limited ("EAG Company") was drafted without due consideration and precision and leaves much room for different interpretations. For instance, although Clause 16 of the agreement provides that "surplus funding from the Games, if any, up to the total amount of Government subsidy provided and hiring charges waived, shall be returned to the Government", the meaning of "surplus funding" is not defined and can be interpreted to mean the overall surplus (i.e. including money provided by sponsors) or the surplus of government funding (i.e. excluding funding from sponsorship);

- recommends that the Administration, in organising similar events in future, should include suitable provisions in the agreements to be signed with relevant parties to cater for different possible scenarios, including the realisation of surplus, so as to avoid ambiguities that may permit wilful misinterpretation;
- is surprised and finds it unacceptable that:
 - (a) despite the fact that the 2009 EAG was the first large-scale international multi-sports event ever held in Hong Kong, the Secretary for Home Affairs and the Director of Leisure and Cultural Services had not conducted a comprehensive post-implementation review ("PIR") to consolidate experience and identify good practices and lessons learnt. Neither had they conducted a comprehensive and systematic financial review on the organisation of the 2009 EAG; and
 - (b) the wash-up review and the survey on participating National Sports Associations ("NSAs") conducted after the completion of the 2009 EAG did not involve formal consultation with key stakeholders, such as the participating National Olympic Committees ("NOCs"), sponsors, broadcasters, volunteers and technical officials;
- recommends that the Secretary for Home Affairs should:
 - (a) promptly compile, for future reference, a report on good practices and lessons identified from hosting of the 2009 EAG, as recommended in paragraph 2.16(a) of the Director of Audit's Report ("Audit Report"); and

- (b) conduct a comprehensive financial review on the organisation of the 2009 EAG;
- recommends that the Administration, in organising similar events in future, should conduct a PIR, including a financial review, after conclusion of the events to consolidate experience and identify good practices and lessons learnt;

Operating cost and revenue

Full direct cost of organising the event

- expresses grave dismay and finds it unacceptable that:
 - (a) when the Home Affairs Bureau ("HAB") sought the FC's funding approval for hosting the 2009 EAG, it had neither ascertained the full direct cost implications of hosting the event nor informed the FC of them; and
 - (b) apart from the government subsidy of \$123 million, additional direct expenditures of \$132.8 million as ascertained by Audit had been incurred by various government B/Ds to support the hosting of the 2009 EAG. However, such expenditures were not mentioned in the funding paper submitted to the FC in January 2006;
- notes the Director of Leisure and Cultural Services' explanation that of the additional direct expenditures of \$132.8 million, \$22.7 million was incurred by the Leisure and Cultural Services Department ("LCSD") for employing about 160 contract staff with resources allocated to the LCSD under the Financial Secretary's initiative in the 2009-2010 Budget for creating temporary jobs, and such expenditure would not have been incurred without the additional provision;
- considers that the \$22.7 million aside, other additional direct expenditures as ascertained by Audit had been incurred by various B/Ds to support the 2009 EAG, and therefore disagrees with the Secretary for Home Affairs' and the Secretary for Financial Services and the Treasury's view that such expenditures should not be regarded as direct expenditures of the Games;

- expresses grave dismay and finds it unacceptable that in the funding paper submitted to the FC in January 2006, the HAB estimated that the gross expenditure for organising and implementing the 2009 EAG would be \$240 million, but as it transpired, the actual expenditure, excluding the additional direct expenditures of \$132.8 million incurred by various B/Ds, was \$291.1 million. Adding those additional direct expenditures, the total expenditure of the Games amounted to \$423.9 million of which \$243.9 million was borne by the Government;

Income and expenditure variances

- finds it appalling and inexcusable that the HAB failed to prepare an estimate of acceptable accuracy of the income and expenditure for the 2009 EAG when seeking the LegCo's approval for hosting the Games, in that:
 - (a) some expenditure items of the 2009 EAG differed significantly from the estimated amounts as stated in the FC paper of January 2006. For example, the estimated and actual expenditure on the opening and closing ceremonies was \$35 million and \$63.4 million respectively (i.e. an increase of 81%); and
 - (b) the actual cost of temporary works for the EAG competition venues was \$48.2 million, against the estimated cost of \$6.2 million, representing a sixfold increase;
- finds it unacceptable that the HAB had not taken the initiative to timely inform the FC or the Panel on Home Affairs of the significant variations in the income and expenditure estimates of the 2009 EAG after obtaining the FC's funding approval in 2006;
- acknowledges that:
 - (a) the Secretary for Home Affairs and the Director of Leisure and Cultural Services have accepted the audit recommendations in paragraph 3.26(a) and (c) of the Audit Report; and
 - (b) for a similar sports event in future, the HAB and the LCSD will aim to provide the FC with accurate estimates of the total direct expenditures and the best possible estimates of the costs of temporary works, and will take into account the reasons for the

variances between the estimated and actual income and expenditure items of the 2009 EAG in preparing budgets;

- strongly urges:
 - (a) the Secretary for Home Affairs, in implementing large-scale events/projects that take years to prepare and implement, to proactively inform the FC of the updated income and expenditure estimates and highlight significant variations which may have arisen due to changes in circumstances over time after the FC's funding approval has been obtained, for the good of public accountability and transparency; and
 - (b) the Secretary for Financial Services and the Treasury to take measures to ensure that all government B/Ds, including the HAB, will implement the Committee's above recommendations by informing the LegCo of the full direct cost implications and updated income and expenditure estimates in launching large-scale events/projects in future;

Cost of temporary works

- finds it unacceptable that in seeking funding of \$823.6 million from the FC in 2007 for both long-term improvement works for the government venues and temporary works for the 2009 EAG, the Administration did not inform the FC of the estimated cost of the temporary works as a separate item;
- acknowledges that:
 - (a) the Secretary for Home Affairs and the Director of Leisure and Cultural Services have accepted the audit recommendations in paragraph 3.26(b) of the Audit Report; and
 - (b) as a result of the experience gained from the 2009 EAG, the estimated project cost for temporary overlay was listed as a separate item by the HAB in the public consultation document issued in 2010 for the bid for hosting the 2023 Asian Games;
- urges the Secretary for Financial Services and the Treasury to take measures to ensure that the cost of the temporary works for a project/event is provided as a separate item in the relevant FC papers;

Legacy project and use of public funds

- notes:
 - (a) that the EAG Company implemented a legacy project of \$10 million in June 2010, which comprised two donations totalling \$9.8 million to support the long-term development of Hong Kong athletes, by utilising the company's operating surplus;
 - (b) the Secretary for Home Affairs' claim that the source of finance for the legacy project was a \$10 million sponsorship received from Sponsor B, instead of the \$10 million sponsorship from Sponsor A as stated in the Audit Report and which had been designated for enhancing the EAG opening ceremony; and
 - (c) the Administration's view that as the \$10 million sponsorship could be differentiated from the government subsidy, it was reasonable not to regard the sum as part of the EAG Company's operating surplus for return to the Government;
- considers that although the implementation of a legacy project to support the long-term development of Hong Kong athletes was a meaningful initiative on its own, the use of the EAG Company's operating surplus to finance the two donations under the legacy project was inappropriate because:
 - (a) according to the Tripartite Agreement, the EAG Company should use all revenue generated solely for the organisation, implementation and delivery of the 2009 EAG, and any surplus funding should be returned to the Government; and
 - (b) neither the FC paper of January 2006 nor the Tripartite Agreement states that the EAG Company would make donations to support the long-term development of Hong Kong athletes;
- finds the Secretary for Home Affairs' claim that the \$10 million sponsorship from Sponsor B was the source of finance for the legacy project totally unacceptable because:
 - (a) according to the Secretary for Home Affairs, the sponsorship of \$10 million was pledged by Sponsor B in November 2009 for the purpose of supporting the 2009 EAG generally without being

designated for any specific EAG activities or expenditure items. The payment of \$10 million was eventually received on 22 January 2010. As Sponsor B had not specified any use for the \$10 million (e.g. funding a legacy project), the sum received should become part of the EAG Company's general pool of resources;

- (b) the LCSD only consulted the HAB on using the EAG Company's surplus funds on the legacy project in early May 2010, which was after the donation from Sponsor B had become part of the EAG Company's general pool of resources. Given that the EAG Company did not maintain separate accounts for government subsidy and sponsorship funds, it is unjustifiable to claim that Sponsor B's sponsorship could be differentiated from the government subsidy and be identified as the source of finance for the legacy project; and
 - (c) during the course of the audit review, Audit could not find records showing that the legacy project was financed by Sponsor B's sponsorship, and neither the HAB nor the LCSD had provided Audit with such information;
- is of the view that the \$10 million for financing the legacy project was paid from the unallocated balance of the EAG Company's general pool of resources, and should be regarded as surplus funding from the 2009 EAG and be returned to the Government according to the Tripartite Agreement;
 - is not convinced by the Secretary for Home Affairs that the allocation of part of the operating surplus of the EAG Company to fund the legacy project was within the scope of policy decisions which he was entitled to make and it was not necessary for the Administration to seek the LegCo's approval. Notwithstanding that the legacy project itself was worthwhile and agreed to by the Administration, it fell outside the ambit of the FC's funding approval for the organisation and implementation of the 2009 EAG, and the operating surplus should be returned to the Government pursuant to the Tripartite Agreement. Hence, the Secretary for Home Affairs has neither discretion nor room to allow the allocation of the operating surplus to fund the legacy project and the Administration should first seek the FC's approval for so doing, in accordance with the established regime for controlling the use of public funds;

- acknowledges that the Secretary for Home Affairs and the Director of Leisure and Cultural Services have accepted the audit recommendations in paragraph 3.26(d) of the Audit Report;
- strongly urges the Secretary for Home Affairs:
 - (a) in making decision to dispose of the surplus of an event funded by government subsidy and/or commercial sponsorship, to ensure that the option pursued is in strict compliance with the terms of the funding allocation and the sponsorship, and consult the LegCo and the sponsors where appropriate; and
 - (b) in organising similar events in future, to consider at the early planning stage whether and how a legacy project should be implemented and make suitable arrangements accordingly;
- strongly urges the Secretary for Financial Services and the Treasury to inform all government B/Ds of the Committee's above recommendations;

Timeframe for administrative arrangements

- expresses concern that as of February 2011, the EAG Company was still under liquidation. As a result, the final audited financial statements of the company had not been submitted to the Government and the EAG Planning Committee, and surplus funds not returned to the Government, hence not meeting the six-month requirement in the Tripartite Agreement;
- acknowledges that the Secretary for Home Affairs and the Director of Leisure and Cultural Services have accepted the audit recommendations in paragraph 3.26(e) of the Audit Report;
- urges the Secretary for Home Affairs and the Director of the Leisure and Cultural Services to closely monitor the progress of the liquidation of the EAG Company to ensure that surplus funds from the 2009 EAG are returned to the Government as early as possible;

Other matters

Admission ticketing arrangements

- expresses concern that:
 - (a) at the commencement of the 2009 EAG, the EAG Company did not provide sufficient on-site box offices at competition venues for selling same-day tickets;
 - (b) the attendance rates of some sports events for which a large number of admission tickets were issued to sponsoring organisations, District Councils and so on were very low, and this effectively deprived other citizens of their opportunities to attend the events; and
 - (c) some sports items had high percentages of unsold tickets;
- acknowledges that the Secretary for Home Affairs and the Director of Leisure and Cultural Services have accepted the audit recommendations in paragraph 6.19 of the Audit Report;
- urges the Secretary for Home Affairs and the Director of Leisure and Cultural Services to draw on the experience of the 2009 EAG and improve the ticketing arrangements, including the issuance of guest admission tickets to sponsoring organisations, in staging similar sports events in future;

Conversion of squash courts into office accommodation

- notes that:
 - (a) the Administration informed the FC in January 2006 that the office accommodation of the EAG Company would be provided by conversion of six squash courts at the Hong Kong Squash Centre ("HKSC") and that the conversion and subsequent reinstatement of the squash courts would cost \$4.4 million; and
 - (b) after completion of the conversion works at the HKSC at a cost of \$4.9 million, the EAG Company used the office accommodation from February 2007 to June 2010;

- expresses concern that:
 - (a) the Administration did not inform the FC of the alternative option of renting a private office in nearby areas of the HKSC and the related cost comparison information when seeking funding for the 2009 EAG in January 2006;
 - (b) the LCSD did not take action to reinstate the six squash courts at the HKSC, which had been used as the EAG Company's former office accommodation, after the return of the accommodation to the LCSD in June 2010. This was at variance with the commitment made to the FC in January 2006; and
 - (c) the use of the six squash courts at the HKSC as office accommodation has deprived the public of the use of the sports facility in the Central and Western District;
- acknowledges that the Secretary for Home Affairs and the Director of Leisure and Cultural Services have accepted the audit recommendations in paragraph 5.14 of the Audit Report;
- urges the Secretary for Home Affairs and the Director of the Leisure and Cultural Services to take early action to convert the EAG Company's former office accommodation at the HKSC into appropriate sports, amenity and cultural facilities to meet the demand for such facilities in the Central and Western District;

Audit survey

- expresses concern that although the overall assessments of the 2009 EAG made by the NOCs and the NSAs in the survey conducted by Audit were "Excellent" or "Good", some NOCs and NSAs have expressed dissatisfaction over the arrangements for competition events, provision of competition venues and facilities, and handling of suggestions and complaints;
- acknowledges that the Secretary for Home Affairs and the Director of Leisure and Cultural Services have accepted the audit recommendations in paragraph 7.9 of the Audit Report;

- urges the Secretary for Home Affairs and the Director of Leisure and Cultural Services to take effective measures to implement the above audit recommendations; and

Follow-up action

- wishes to be kept informed of the progress made in implementing the various recommendations made by the Committee and Audit.

A. Introduction

The Audit Commission ("Audit") conducted a review of the Hong Kong Export Credit Insurance Corporation ("ECIC").

2. The Committee did not hold any public hearing on this subject. Instead, it asked for written responses to its enquiries.

B. Governance structure of the ECIC

3. As stated in paragraph 1.2 of the Director of Audit's Report ("Audit Report"), the ECIC was established in 1966 under the ECIC Ordinance (Cap. 1115). According to paragraphs 2.2 and 2.3, an Advisory Board was established under the ECIC Ordinance to advise the ECIC in the conduct of its business. The Advisory Board is not a governing board of the ECIC and under the ECIC Ordinance, the ECIC shall not be bound by the advice of the Board.

4. To ascertain whether the governance structure of the ECIC, including the role of the Advisory Board, was in line with overseas practice nowadays, the Committee enquired about the governance structure of comparable organisations in overseas countries which performed functions similar to those of the ECIC.

5. In his letter of 12 May 2011 (in *Appendix 15*), the **Secretary for Commerce and Economic Development** provided a table comparing the products and services offered by the ECIC and other export credit agencies ("ECAs") in 10 different countries in the Asia Pacific, Europe and North America, and a description of their governance structure. He also stated that:

- all of the ECAs listed in the table, except for the one in Singapore which had been privatised in 2003, were 100% owned by the respective Governments and were members of the Berne Union which was the leading international organisation of public and private sector providers of export credit and investment insurance;
- the listed ECAs were established in different forms, e.g. as government departments, public corporations, banks or as a publicly listed company. However, none of them had functions which were identical to the ECIC.

All of them offered wider range of products and services (including loans, project financing, investment insurance and banks guarantees) than those of the ECIC;

- the ECA in New Zealand, which performed functions most similar to the ECIC, had an advisory board structure; and
- in view of the more focused services offered by the ECIC, the Commerce and Economic Development Bureau ("CEDB") considered that the present governance structure of the ECIC was appropriate.

6. Notwithstanding the CEDB's view that the ECIC's present governance structure was appropriate, the Committee noted Audit's recommendations in paragraph 2.7 of the Audit Report that there was a need for the Government to regularly review the ECIC's governance and the CEDB's monitoring mechanism. The Committee therefore asked the CEDB:

- how the ECIC's present governance structure could address the issues raised by Audit in paragraph 2.6 of the Audit Report; and
- how the CEDB would proceed with the review of the governance and monitoring mechanism over the ECIC's work and performance, as undertaken by the Secretary for Commerce and Economic Development in paragraph 2.8(a) of the Audit Report.

7. In his letter of 23 May 2011 (in *Appendix 16*), the **Secretary for Commerce and Economic Development** informed the Committee of the actions that had already been taken or were being implemented by the ECIC and the CEDB regarding the issues raised by Audit, based on the existing governance structure of the ECIC, as follows:

Rapid business expansion

- both the CEDB and the Advisory Board of the ECIC would continue to monitor closely the growth of the ECIC's insured business and ensure that the Government's guarantee would remain sufficient for it to carry out its statutory duties effectively. The CEDB noted that with the gradual recovery of the global economy, the increase in demand for the ECIC's services had slowed down significantly;

Role of Advisory Board

- the ECIC was reviewing its guidelines for determining the types of issues (and the timeframe) which should be submitted to the Advisory Board and its committees for advice and would seek the Advisory Board's endorsement on these guidelines upon the completion of the review. Meanwhile, the Advisory Board discussed and agreed at its meeting held on 23 March 2011 on the issues to be submitted to the Advisory Board for information and advice for all meetings scheduled in 2011-2012;

Role of the CEDB

- while the present mechanism already enabled the ECIC to incorporate the Government's views into its annual corporate plan/budget through discussions at the Advisory Board, the CEDB had asked the ECIC to submit its annual corporate plan/budget to the Secretary for Commerce and Economic Development for formal approval from this year onwards after seeking the endorsement of the Advisory Board;

Scope of the ECIC's services under the ECIC Ordinance

- in response to the recommendation in paragraph 4.58 of the Audit Report, the CEDB had sought legal advice which reconfirmed that the services provided by the ECIC were consistent with the true intent, meaning and spirit of section 9(3) of the ECIC Ordinance;

Monitoring of the ECIC's work and performance

- while the CEDB currently did not micro-manage the daily operations of the ECIC, it had recently reviewed the situation and had further stepped up its monitoring by requiring the ECIC to submit the ECIC's annual corporate plan/budget to the Secretary for Commerce and Economic Development for formal approval from this year onwards, after seeking the endorsement of the Advisory Board. As regards the half-yearly housekeeping meeting between the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) and the ECIC, in addition to its business and financial performance, the ECIC also reported regularly on its management and operational matters including internal audit, human resource management, reinsurance arrangement and development plans for new services. The CEDB

would continue to assess through the annual corporate plan/budget and its regular liaison and housekeeping meetings with the ECIC on how effectively the ECIC discharged its public mission; and

Administrative irregularities identified

- in 2009, the ECIC commissioned a consultancy study on the internal control procedures of the ECIC on a number of areas including tendering and disbursement of IT development and consultancy projects. A number of administrative irregularities had been identified. All of the consultant's recommendations to address the irregularities had been implemented in the same year before Audit commenced its audit review on the ECIC. Since then, the ECIC had regularly reviewed its internal control. An internal audit unit was set up in 2010 to audit the work of each division of the ECIC and its plan was to complete a full internal audit within three years. It would submit a report on each division to the Audit Committee (under the Advisory Board) which would, in turn, put forward its recommendations to the full Board for consideration.

8. Regarding his response given in paragraph 2.8(a) of the Audit Report, the **Secretary for Commerce and Economic Development** stated in his letter of 23 May 2011 that the findings on the governance structure and operation of overseas ECAs, which were provided to the Committee in his previous letter, were based on information in websites and documents available to the public. To get a better understanding of the governance and operations of those ECAs, the CEDB would ask the ECIC to write to those ECAs for more information. Upon receipt of additional data from the organisations, the CEDB would further review the governance of the ECIC and report back to the Legislative Council Panel on Commerce and Industry ("CI Panel") on the outcome of the review.

9. In response to the Committee's enquiry about the timetable for completing the review and reporting to the CI Panel, the **Secretary for Commerce and Economic Development** advised, in his letter of 26 May 2011 (in *Appendix 17*), that the CEDB planned to report the outcome of the review of the governance of the ECIC to the CI Panel before the end of 2011.

C. Conclusions and recommendations

10. The Committee notes the above replies of the Secretary for Commerce and Economic Development. Given that the ECIC was established in 1966, the Committee is concerned that its governance structure, as prescribed by the ECIC Ordinance, may not be in line with modern-day practices and requirements. As the CEDB does not micro-manage the daily operations of the ECIC, the Committee considers it all the more important for the Advisory Board to play the role of a governing board to monitor the work and performance of the ECIC as well as oversee its governance. The Committee recommends that the Secretary for Commerce and Economic Development should expeditiously conduct the review of the governance of the ECIC, taking into account the Committee's concerns, and report the outcome to the CI Panel before the end of 2011.

11. The Committee also wishes to be kept informed of the progress and outcome of the review, as well as the progress made in implementing the various recommendations made by Audit.

A. Introduction

The Audit Commission ("Audit") conducted a review of the management of the Hong Kong Housing Authority ("HA")'s commercial properties with focus on the following areas:

- management of retail premises;
- management of car parks;
- management of factory estates;
- performance measurement and reporting; and
- the way forward.

2. **Mr D W PESCOD, Director of Housing**, made an opening statement at the public hearing on 12 May 2011. The full text of his statement is in **Appendix 18**. The supplementary information provided by the Housing Department ("HD") in May 2011 for the public hearing is in **Appendix 19**.

B. Management of retail premises

Day-to-day management of retail premises

Mechanism of managing retail premises

3. According to paragraphs 2.7 and 2.8 of the Director of Audit's Report ("Audit Report"), HD frontline staff (or security guards) are required to conduct daily patrols of the HA's retail facilities and the HD has implemented a unit-to-unit inspection system since July 2010. Under the system, HD staff (or contractor staff in the case of outsourced premises) are required to visit each retail shop, market stall and cooked food stall within the 18-month cycle to check the shop/stall conditions and to detect any breach of tenancy conditions. Notwithstanding the requirements, Audit found that there were cases of suspected abuse or improper use of retail premises. There were also cases involving suspected gambling activities, retail premises not regularly open for business, and obstruction problem.

4. To ascertain whether the HD had effectively monitored the management of HA retail premises, the Committee asked about the HD's mechanism in place for monitoring the management of retail premises, particularly how the HD enforced its instructions and guidelines, and the reporting channels for frontline staff to report irregularities to the senior management.

5. The **Director of Housing** and **Mr LEE Kwok-wing, Deputy Director (Estate Management) of the HD**, responded that:

- the HD, as the executive arm of the HA, was responsible for day-to-day management of retail premises. The Deputy Director (Estate Management) was assisted by three Assistant Directors and their subordinates in managing all retail premises, including those directly managed by the HD and those outsourced to property management contractors ("contractors"); and
- the HD had issued clear guidelines to its staff on how to enforce the Housing Ordinance (Cap. 283) and the mechanism for reporting irregularities in retail premises. The Deputy Director (Estate Management) and the three Assistant Directors met weekly to review the management of retail premises.

6. The Committee further asked about the details of the reporting mechanism and whether irregularities would be reported to the senior management on a regular basis.

7. The **Deputy Director (Estate Management)** replied that:

- since nearly 70% of the retail facilities were outsourced to contractors for day-to-day management, the HD counted on the contractors to report any irregularities to the Assistant Directors through district chief managers and senior managers of individual estates; and
- the HD would also monitor the performance of contractors in each district regularly by inspecting their documents and conducting surprise checks. If there had not been any serious problems in the management of the estates, district staff might not report the irregularities to the senior management. When there were special issues of concern in the

estates, district staff would report them to the senior management according to the reporting mechanism.

8. The Committee was concerned that although a reporting mechanism was in place, irregularities in retail premises still persisted over the years. To ascertain whether the HD had deployed adequate manpower to oversee the management of retail premises, the Committee asked:

- about the scope of duties of senior managers and their working location; and
- whether there was any requirement on the frequency of senior managers visiting housing estates.

9. The **Director of Housing** and the **Deputy Director (Estate Management)** replied that:

- duties of senior managers included tenancy management and estate management of all premises in the housing estates. At present, the HD deployed 16 senior managers to oversee the management of about 180 housing estates. In other words, each senior manager would oversee an average of 12 housing estates. Senior managers worked in the district offices; and
- HD staff were required to submit monthly reports on the premises managed by the HD while outsourced contractors were required to submit quarterly reports to the HD's senior management for monitoring purpose. Senior managers were required to review the reports and visit the housing estates under their charge quarterly. The HD was aware that some of the irregularities were deliberate acts by organised groups and could not be solved in the short term or simply by increasing the manpower.

10. The Committee queried why the HD was unable to detect the irregularities identified by Audit, despite that senior managers were required to visit the housing estates under their charge quarterly.

11. In response, the **Deputy Director (Estate Management)** and **Mr LIU King-leung, Assistant Director (Estate Management) 3 of the HD**, replied that the unit-to-unit inspection regime had only been implemented since July 2010. As senior managers oversaw the overall management of housing estates, apart from monitoring HD frontline staff and contractors in properly carrying out their duties of inspecting retail premises, they were also responsible for reviewing the operating expenditure of the estates, service standard provided by HD frontline staff and contractors, cleansing and security services, and dealing with complaints. As such, senior managers could only focus on the major issues of concern in the management of estates, such as by reviewing the inspection reports.

12. The Committee further asked whether housing managers would provide assistance to senior managers when senior managers conducted their quarterly visits of housing estates, such as by accompanying the senior managers and highlighting the major issues of concern in the estates to them.

13. The **Assistant Director (Estate Management) 3** replied that:

- housing managers would normally accompany senior managers on their visits to the housing estates. When irregularities were observed during the inspections by HD frontline staff and contractors, they would try their best to deal with the problems themselves. In case they were unable to deal with the problems with their existing resources, they would report to the headquarters for its support. Normally, housing managers and their subordinates were able to handle general and routine matters in the estates; and
- the HD was reviewing the scope of major issues of concern which should be reviewed by senior managers with a view to improving the management of retail premises. As there was a wide spectrum of management work in an estate, it would be difficult for senior managers to inspect every aspect in detail.

14. The Committee noted from paragraph 1.5 of the Audit Report that the Commercial Properties Committee ("CPC") was a standing committee of the HA and was responsible for advising the HA on policies concerning its commercial, industrial and other non-domestic facilities, and optimising financial return on its investment. In order to understand the role of the CPC in dealing with the irregularities in HA retail premises, the Committee asked about the frequency of the

CPC's meetings and whether there was a regular agenda item on reviewing the irregularities mentioned in the Audit Report.

15. In response, **Dr Andrew CHAN Ping-chiu, Chairman of the CPC**, said that:

- the CPC held nine meetings last year, including two special meetings and brainstorming meetings. The HD reported the overall occupancy and vacancy rates of retail premises to the CPC; and
- the CPC had also conducted site inspections to the HA's commercial, industrial and other non-domestic facilities. When the CPC observed any irregularities during the site inspections, it would refer them to the HD for follow-up. The CPC was aware that some let-out retail premises were not open for business (i.e. non-trading) and knew that there was at present no provision in the HA's tenancy agreements that required retail shops and cooked food stalls to open for business for any minimum hours per day or minimum days per week. The HD would review the feasibility to specify opening hours in tenancy agreements appropriate to the nature of business and customer demand in respect of the retail facilities, having regard to the best interest of the domestic tenants.

Suspected gambling activities

16. As reported in paragraphs 2.12 and 2.13 of the Audit Report, suspected gambling activities, such as groups of people playing mahjong/tin kau cards, appeared prevalent in some of the retail premises visited by Audit. The Committee noted that the HD was aware of the problem as early as 1997 and had issued an internal instruction requesting all estate housing managers to take positive action to deal with suspected gambling activities. The Committee asked:

- why gambling activities were still prevalent over the years despite the HD's instruction; and
- whether there were any loopholes in the system for dealing with the gambling problem.

17. The **Director of Housing** replied that:

- the HD worked closely with the police to enforce the law against serious institutionalised gambling which might involve commercial operation. Tenancy enforcement actions including issuance of notice-to-quit would be taken in case of conviction; and
- for day-to-day activities in common areas, such as individual tenants playing tin kau, the HD would try to persuade them not to do so by working with different agencies or organisations in the estates. The problem of gambling could not be solved completely and the HD was doing its best to deal with the problem within the means available.

18. As requested by the Committee, the **Director of Housing** provided a copy of the internal instruction issued by the HD in 1997 on dealing with gambling activities in Annex II of his letter of 16 May 2011 (in *Appendix 20*). According to the instruction, HD staff (and contractor staff) were required to follow through the measures laid down in the instruction, which included forming small teams to patrol those areas known to the Estate Office with gambling activities and organising regular joint abatement action by estate staff and the police. However, the Committee noted from paragraph 2.14 of the Audit Report that there were cases in which gambling activities were not reported to the police and no notice-to-quit were served on a tenant who was convicted of illegal gambling. The Committee asked:

- whether the instruction was still in force, and why HD staff (and contractor staff) had not vigilantly followed the measures laid down in the instruction over the past 14 years; and
- whether a hotline had been set up for reporting suspected gambling activities.

19. The **Director of Housing** replied that:

- HD staff had been following through the measures laid down in the instruction. In the last year, the HD had carried out 150 joint exercises with the police to combat illegal gambling activities. There had been no discrepancy between the instruction and the actual practice; and
- there were hotlines which handled all sorts of complaints, including complaints on gambling.

20. The Committee noted that a marking scheme had been implemented in HA retail premises since October 2006 under which penalty points would be allotted according to the seriousness of misdeeds. Referring to Appendix C of the Audit Report which set out the scheduled misdeeds under the marking scheme, the Committee asked:

- about the reasons for not including improper and unauthorised use of retail premises, such as gambling, as misdeeds under the marking scheme; and
- whether the HD would consider modifying the existing marking scheme to cover uses of retail premises which were improper but might not be prohibited by law.

21. The **Deputy Director (Estate Management)** and the **Assistant Director (Estate Management)** 3 responded that:

- the marking scheme was adopted with the objective of sustaining a clean, hygienic and tidy environment in retail premises. Under the existing practice, the HD would report all illegal gambling activities to the police immediately once they were found; and
- in some circumstances, termination of tenancies could be an effective means to deal with breaches of tenancy conditions. However, the HD would consider whether it would be feasible to establish a marking scheme to deal with improper use of retail premises.

22. Case 1 in paragraph 2.9 of the Audit Report revealed that there were two adjacent storerooms in a shopping centre in which an opening was made to the partition wall between them without the HD's approval. The Committee asked whether the HD would also consider modifying the existing marking scheme to cover unauthorised alteration of premises.

23. The **Assistant Director (Estate Management)** 3 replied that:

- as there was a diversity of irregularities in retail premises, the HD considered it impossible to include all misdeeds in the marking scheme. The HD would follow up any breaches of tenancy conditions by issuing warning letters, conducting interviews with tenants and explaining to

them that their behaviour was unacceptable. If the irregularities still persisted, a notice-to-quit would be served on the tenants concerned; and

- the two storerooms mentioned in Case 1 had already been recovered by the HD.

Retail premises not regularly open for business

24. The Committee referred to paragraph 2.17 of the Audit Report, which revealed that 33% of the let-out retail shops and market stalls in a shopping centre in Tsuen Wan were not regularly open for business. However, there was no provision in the HA's tenancy agreements of retail shops and cooked food stalls for regulating the non-trading problem. In the tenancy agreement for market stalls, the non-trading rule stipulated that the tenant should not cease to carry on business at the stall for more than seven consecutive days. Compared to the non-trading rule of the Food and Environmental Hygiene Department, the HA's rule seemed to be less stringent, as a tenant could open for business only one day per week without breaching the tenancy agreement. The Committee asked whether:

- the HD would review the non-trading rule stipulated in its existing tenancy agreements; and
- the HD maintained records on whether retail premises were open for business and the contents of such record, if any.

25. The **Director of Housing** and the **Deputy Director (Estate Management)** replied that:

- there were different reasons leading to the non-trading situation. Some sole proprietors, such as electricians, operated a shop but provided services elsewhere. As such, they could only open the shop for very limited times. There was another case in which a tenant operated a computer repair shop on a part-time basis. As long as he was providing the services, the HD did not consider that was a particular problem. Sometimes, business operators chose not to operate during normal business hours but operate in the evening or at night because of particular commercial location. The HD had to accommodate different situations and exercise flexibility as long as the businesses were operated in legitimate ways. The HD was reviewing the lease

conditions in terms of operating hours and continuous business of the premises; and

- the HD maintained records on whether retail premises were open for business but such records were informal in the past. With Audit's recommendations, the HD had begun to maintain the records systematically.

Letting of retail premises and implementation of improvement measures

26. As revealed in Table 3 in paragraph 2.23 of the Audit Report, many HA retail premises had remained vacant for a long time. Of the 251 vacant retail premises, 122 had been vacant for more than three years, in which 91 had even been vacant for more than five years.

27. The Committee queried whether the HD had taken effective measures to let out the vacant retail premises or prompt actions to explore viable options to optimise their use, such as approaching those tenants who were forced to close their shops after The Link Real Estate Investment Trust ("The Link REIT") had taken over the HA's commercial properties and inviting young people to start their own business in the vacant premises.

28. As regards the vacancy problems in markets, paragraph 2.37 of the Audit Report stated that although re-ordering exercises had been conducted in a number of markets, there were still five markets with a consistently high vacancy rate of over 30% for the past five years. The Committee also pointed out that there were complaints about poor hygienic conditions, poor illumination, and lack of air-conditioning in the markets, resulting in low patronage and poor business. As such, the markets could not attract bidders.

29. Against the above background, the Committee asked:

- about the measures taken by the HD to let out the vacant retail premises; and
- whether the HD would allocate more resources to improve those markets with poor conditions so as to attract more tenants, or consider converting the markets to other gainful uses.

30. The **Director of Housing** and the **Deputy Director (Estate Management)** stated that:

- the HD had taken initiatives to reduce the vacancy rate of markets through market re-ordering, i.e. by grouping vacant market stalls together at one side of the market to create a better retail atmosphere, and conversion to other uses to suit residents' need. As a result, there had been a drastic reduction in the vacancy rate of markets from 22% in 2005 to 9% in 2011. The HD's objective was to attract more commercial tenants in order to keep the markets open, as closing down the markets would affect the services provided to domestic tenants;
- there had been a significant improvement in the overall vacancy rate of retail shops which had dropped from 7.6% in 2006 to 5% in 2011 through implementing a number of improvement measures. Given that some of the retail premises were old-aged facilities in unpopular locations with inferior accessibility, there had been a high vacancy rate in individual estates with unattractive retail facilities. Wah Fu (II) Estate was an example. It was situated on an upper platform and residents preferred buying food in the market of Wah Fu (I) Estate, which was located near a bus stop and on a lower platform;
- the HD would intensify its efforts to further reduce the vacancy rate of retail premises by adopting flexible letting terms and tendering procedures, such as conducting open instant tenders, offering short-term tenancy and longer rent-free period. The HD would also convert surplus facilities to other uses and implement major improvement works for asset enhancement. Tenants of The Link REIT were welcome to submit a bid for vacant premises;
- the HD had been considering improving those markets with poor conditions. However, some markets were designed long time ago and could not accommodate air-conditioning facilities at a viable cost. As such, the HD would look into other solutions to solve the problem. The CPC had approved the HD's proposal to earmark four major retail facilities (at On Kay Court, Pok Hong Estate, Wah Fu (I) Estate, and Wah Fu (II) Estate) for early consideration of major improvement works. The HD would also improve the accessibility of Wah Fu (II) Estate by adding lifts and escalators; and

- to attract more bidders for vacant retail premises, the HD also advertised vacancies of retail premises. Tender notices were published in leading newspapers every Friday and uploaded onto the HA's website.

31. The Committee further referred to Case 2 in paragraph 2.28 of the Audit Report which revealed that a vacant retail shop had been repeatedly re-designated for different trades, some of which were very similar, based on HD staff's own knowledge and experience in over 25 unsuccessful re-tendering exercises since 2004. The Committee asked:

- whether and when the HD would review the situation where there was no bidder of a vacant retail premises after several re-tendering exercises;
- whether the HD had conducted market research on the actual demand of vacant premises by commercial tenants, and whether it was aware that some industries or arts groups had difficulties in finding an appropriate premises for operation; and
- whether the HD had considered using those vacant premises with low commercial value as community facilities like study rooms.

32. The **Director of Housing**, the **Deputy Director (Estate Management)** and the **Assistant Director (Estate Management)** 3 replied that:

- the HD had been reviewing Case 2 on an ongoing basis and identifying alternative uses of the premises to match the demand of potential tenants. While the HD was aware of the needs of arts groups for premises, it had to cater to the needs of domestic tenants for services like shops and restaurants. Regarding Case 2, the HD had repeatedly re-designated the vacant retail shop, which was located in Wah Fu (II) Estate, for different trades over the years with a view to attracting interested bidders. The HD had also conducted a strength-weakness-opportunity-threat ("SWOT") analysis to identify the causes of the problem. It was in the process of re-letting the shop and interested parties/potential tenderers were allowed to suggest possible trades;
- the HD conducted SWOT analysis to gather market information on a regular basis. For example, the HD had been studying comprehensive market information in respect of a new development in Yau Tong; and

- the HD had been converting vacant premises with low commercial value into community facilities. For instance, it had converted a vacant cooked food stall in Chak On Estate into a library and the vacant cooked food stalls in the Shun Lee Tsuen into a platform for residents to organise activities or carnivals. The HD had recently arranged with the Hospital Authority to take up a number of units in Wah Fu (II) Estate to provide an elderly care centre and an elderly education centre.

33. The Committee further asked:

- about the rank of staff who were involved in the conduct and review of tendering exercises for vacant premises; and
- when a case of no bidder in a tendering exercise would be brought up to the attention of staff at the Deputy Director or Assistant Director levels.

34. The **Assistant Director (Estate Management) 3** replied that:

- when a tenant terminated a tenancy and returned the premises to the HD, the senior housing manager of the Commercial Properties Support Services Section of the HD would study whether it would be appropriate to conduct an open tender to let out the premises, and a tendering exercise would be conducted where appropriate. For some special premises, the HD would let them out by direct negotiation and the prospective tenants on the client list of the selected trade would be invited to submit leasing proposals to the HD for consideration;
- the HD would take the advice of Audit to encourage prospective tenants to make trade suggestions when re-letting vacant retail premises with a view to letting out the premises as soon as possible; and
- the chief estate surveyors and the Assistant Directors concerned would review the vacancy rate of retail premises quarterly and look for alternatives to let out the premises if it had been vacant for four months.

35. The Committee referred to the HA's commercial operating account in Table 1 of paragraph 1.3 of the Audit Report and asked:

- why the expenditure on welfare premises was relatively low, as compared to that on retail premises, car park and factory estate; and
- whether the operating surplus had included those generated from properties directly managed by the HD and those outsourced to contractors.

36. The **Director of Housing** and the **Deputy Director (Estate Management)** responded that the commercial operating account referred to in Table 1 had included those managed by the HD and those outsourced to contractors. Since the occupancy rate of welfare premises tended to be stable and not much maintenance work was required, the expenditure incurred by the HD for welfare premises tended to be low.

37. As requested by the Committee, the **Director of Housing** provided further information on the commercial operating accounts and the 37 major retail facilities listed in Appendix B of the Audit Report in his letters of 16 May 2011 (in *Appendix 20*) and 30 May 2011 (in *Appendix 21*).

Monitoring of operating expenditure

38. According to paragraphs 2.45 to 2.47 of the Audit Report, there was a case in which the area of an estate belonging to welfare premises was wrongly regarded as retail premises. As a result, the actual area was overstated by nearly four times and the unit operating expenditure understated by about 80%. There were also cases in which the daily expenses, such as the security or cleansing expenditure, were not charged to the correct business accounts. As such errors could easily be detected, the Committee questioned why such errors occurred, and whether senior managers would cross check the accuracy of data input by HD frontline staff regularly.

39. The **Assistant Director (Estate Management) 3** responded that:

- at the beginning of each month, contractors would send the bills for settlement by the HD. After certifying the bills correct, payment would be made to the contractor. Management officers or housing officers would then input the data of the expenses, breaking them down into different types of business accounts, into the computer. As

finalising the account of operating expenditure of the whole estate took about one to two months, some HD staff might not be aware of the errors in data if the overall operating expenditure did not exceed the HD's benchmarks. As regards the case mentioned in paragraph 2.45(c) of the Audit Report, the frontline staff concerned had input the data incorrectly by mistake;

- since senior managers were responsible for the overall management of housing estates, it was the responsibility of the Commercial Properties Support Services Section in the headquarters to check the accuracy of the operating expenditure. The HD had recently provided specific training courses on accounting guidelines and principles for charging business accounts to local management staff. With such measure, the HD hoped that its frontline staff would be able to input the data correctly in future; and
- according to the existing guidelines, the operating statements should be reviewed every three months. Apart from senior managers, district chief managers, Assistant Directors and Deputy Director concerned would also visit the estates regularly to ensure that the quality of overall management service met the required levels.

C. Management of car parks and factory estates

40. As stated in paragraph 3.2 of the Audit Report, of the HA's 117 car parks, 3% were directly managed by the HD whereas 97% were outsourced to private operators or carpark operators. The Committee asked why the HD still kept managing such a small portion of car parks. The **Assistant Director (Estate Management)** 3 replied that since there were only few parking spaces in some estates, it would not be cost-effective to outsource the management of the car parks concerned.

41. The Committee then referred to paragraph 4.15 of the Audit Report, which stated that since 1989, it had been the policy of the HA to absolve itself from the ownership and management of factory estates in the long term ("the 1989 policy"). However, up to January 2011 (after more than 21 years), the HD had not formulated a long-term strategy to implement the 1989 policy. The Committee also noted that one of the six newer factory estates built in or after 1979 (i.e. Hoi Tai Factory Estate) had been running at a deficit for two consecutive years (\$0.4 million in 2008-2009 and \$0.9 million in 2009-2010). The Committee asked why the HD had still not implemented the 1989 policy after a long time.

42. The **Director of Housing** replied that:

- the HD reviewed the 1989 policy on a regular basis. In 2008, due to the economic downturn, the HD did not recommend closure, renovation or redevelopment of the Chai Wan Factory Estate ("CWFE"). In March 2011, the CPC approved a plan to clear the CWFE;
- for the six newer factory estates, they had an occupancy rate of nearly 99%. In view of the limited supply of small factory units in the private sector, some tenants would have difficulties in finding alternative accommodation in private industrial developments. The HD had recently obtained the agreement of the CPC to continue the management of the six factory estates and would review the situation from time to time; and
- the reason for the Hoi Tai Factory Estate running a deficit was that the HD had carried out a substantial renovation project in the building with a view to improving its standard and allowing its continuous operation.

43. It appeared to the Committee that following the agreement of the CPC to continue the management of the six newer factory estates, the HA's 1989 policy had since been changed. The Committee asked:

- when the CPC made the decision and whether the decision was made after the matter was raised by Audit; and
- whether the HD had informed the Legislative Council ("LegCo") about the policy change.

44. The **Director of Housing** stated in his reply of 31 May 2011, in **Appendix 22**, that members of the CPC noted the continued demand for the 8,000 small factory units in the six newer factory estates of the HA at the meeting held on 28 April 2011. In view of their high letting rate (i.e. over 99%), CPC members supported the HD's proposal to continue managing them *pro tem* and to review the situation from time to time. The HD would inform the LegCo if there was a substantial change to the long-term policy on the ownership and management of the factory estates in future. He also provided a copy of the relevant CPC paper to the Committee.

45. The Committee noted that the CPC paper was issued on 20 April 2011 for the purpose of informing CPC members of the major findings, recommendations and the management response to the Audit Report, indicating that the modification to the 1989 policy was decided after the matter was raised by Audit.

46. According to Case 3 in paragraph 4.25 of the Audit Report, a tenant had ceased operation in four units of Factory Estate 1 for eight years and the premises had been sublet to different third parties for two to 11 years. Case 4 in the same paragraph of the Audit Report also revealed that a unit had been sublet to a third party as early as in February 2004. The Committee queried:

- why the HD could not detect the cases over the years; and
- whether HD staff had carried out the inspection of each factory unit regularly.

47. The **Assistant Director (Estate Management) 3** replied at the public hearing and the **Director of Housing** stated in his letter of 16 May 2011 that the HD requested its frontline staff to conduct unit-to-unit inspections on factory estates. Besides, the HD had revised the Factory Estate Operational Manual which provided guidance on patrolling and inspections. HD frontline staff was now required to complete and sign an inspection report for each unit and their supervisors were required to cross check their work. With such measures, the HD expected that cases of subletting factory premises would be detected more promptly.

D. The way forward

The 2005 divestment exercise

48. In July 2003, the Chief Executive in Council decided that the HA's agreement should be sought to divest its retail and carpark ("RC") facilities, and that the net proceeds from the divestment should entirely go to the HA. In the same month, the HA agreed in principle to divest its RC facilities. One of the reasons for the divestment was that with the cessation of construction and sale of Home Ownership Scheme flats, the HA lacked a recurrent source of income. Proceeds from the divestment would help the HA meet its funding requirements in the short term.

49. The HA decided that the divestment project would include 180 RC facilities. In addition, an REIT structure (i.e. The Link REIT) would be established and listed on the Stock Exchange of Hong Kong to hold the HA's RC facilities to be divested; and at a later stage when the preparation of relevant land leases was completed, the HA would transfer the legal title of the RC facilities to The Link REIT.

50. As revealed in paragraph 6.9 of the Audit Report, at the time when The Link REIT was listed in November 2005, the HA could only transfer to it the legal title of 76 divested properties. For the remaining 104 properties, only beneficial ownership was transferred at that time. According to The Link REIT's Initial Public Offering ("IPO") Circular, it was intended that the HA would transfer the legal title of the properties to The Link REIT in batches by mid-2008. As it transpired, the HA re-scheduled the completion date for the whole transfer project to July 2010 and the revised timeframe was eventually met.

51. The Committee noted from paragraph 6.13 of the Audit Report that although it was intended that the legal title of the remaining 104 divested properties would be transferred to The Link REIT in batches by mid-2008, there were 54 divested properties the legal title of which could only be transferred to The Link REIT after mid-2008. The late completion of the transfer process had caused a delay in charging government rent on the divested properties. Audit estimated that the financial implications (i.e. notional government rent chargeable from mid-2008 to July 2010) could have amounted to some \$30 million.

52. Given that the late completion of the title transfer process had deprived the right of the Government to charge government rent on the divested properties from mid-2008 to July 2010, resulting in a loss amounted to some \$30 million, the Committee asked about:

- the reasons for the late completion of the transfer of legal title of each of the 54 divested properties; and
- how the original target completion date of mid-2008 was set and whether it was a realistic target.

53. The **Director of Housing** replied that the original target date was decided after a lot of consultations. It was set based on assumptions and was considered to be a reasonable date at that moment.

54. In his letter of 24 May 2011 in *Appendix 23*, the **Director of Housing** provided detailed reasons for the late completion of the title transfer process. He stated that the procurement of leases and Deeds of Mutual Covenant ("DMCs") after the sale of beneficial interest of the divested properties was an unprecedented task. The work involved in the procurement process was much more complex and onerous than could be anticipated at the time of planning and of divestment. During the procurement process, new requirements and restrictions were imposed by various government departments. There was also a host of other unforeseen issues seriously affecting the progress. In the light of the circumstances, it was necessary to revisit and revise the original target completion date for the transfer of legal title. The details were as follows:

Certification of gross floor area ("GFA") under lease

- new procedures and requirements on certification of GFA under lease were introduced by the Lands Department ("LandsD") in end 2005, shortly after the listing. Pending finalisation and issuance of the new procedures and requirements by the LandsD, progress of the programme was seriously affected until end 2006. Moreover, the changes resulted in considerably longer processing time for individual leases, which in turn significantly affected the overall programme;

Planning issues

- new planning requirements regarding carving out of free standing Government, Institution and Community facilities from lease boundaries and building height restrictions were raised by the Planning Department ("PlanD") in early 2007. The HD made repeated representations to the PlanD for not applying the new planning requirements to the remaining properties, particularly in relation to those leases of which approval in principle had already been granted by the LandsD. However, the PlanD considered that no exceptions could be allowed. Significant additional liaison work was thus required with relevant government departments on the determination of the revised boundary and on granting of appropriate rights and easements, including for those leases on which approval in principle had been granted by the LandsD. The lease finalisation work was inevitably deferred as a result. Subsequent

preparatory works for DMC and title transfer were also seriously affected;

DMC issues

- the assignment programme had been further affected by revisions to the Model DMC required by the Legal Advisory and Conveyancing Office of the LandsD to align with the new DMC requirements. There were also changes necessitated by the legislative amendments then introduced;

Other complications

- the situation was further aggravated by unexpected complications which arose from time to time during the processing of individual leases, for example:
 - (a) presence of structures with historical values within the site;
 - (b) requirement to demolish structures or transplant trees erected over the Drainage Reserve Area;
 - (c) requirement to protect highway structures and to build in appropriate lease clauses;
 - (d) reservation of land stratum for new railway lines to pass through;
 - (e) inclusion of slopes within lot boundaries for maintenance;
 - (f) resolution of projecting structures from the lot over government land or private lot; and
 - (g) resolution of encroachment over adjoining lot or vice versa; and
- such complications required additional negotiations with relevant government departments and parties, re-submission to the LandsD for approval and/or preparation of complex legal documentation.

55. Noting the difficulties encountered by the HA during the transfer of legal title, the Committee wondered why the HA had not sorted out the matter before the listing of The Link REIT. The Committee queried whether the HA was too rush to

sell its properties to The Link REIT without thoroughly considering all the implications.

56. The **Director of Housing** explained at the public hearing and in his letter of 24 May 2011 that the land on which most of the public housing estates were situated, including RC facilities within the estates, was vested in the HA by the Government under a vesting order. To complete the transfer of legal title of the divested properties to The Link REIT, it would first be necessary for the HA to obtain land leases from the Government and to enter into relevant DMCs for those properties. Owing to the large number of properties under the divestment portfolio, when The Link REIT was listed in November 2005, it was only possible to transfer to The Link REIT both the legal titles and beneficial ownership for 76 out of the 180 properties sold to The Link REIT. For the remaining 104 properties, only beneficial ownership was transferred at that time. Accordingly, agreements were entered into between the Government and the HA, and between the HA and The Link Properties Limited to provide for, inter alia, the transfer of legal title to the remaining properties to The Link REIT subsequent to its listing.

57. Given that The Link REIT could commence collecting rental charges for the 104 properties after the transfer of beneficial ownership in November 2005 but it was only required to pay government rent for such properties upon transfer of their legal title at a later stage (i.e. by mid-2008), the Committee queried if the Administration had taken effective measures to protect the interests of the Government and taxpayers. The Committee asked:

- whether the legal advisers engaged by the Administration had assessed and advised the Administration on the risks and potential financial implications of a delay in transferring the legal title of the divested properties from the perspective of the Government and taxpayers; and
- whether the overall valuation of the divested properties had reflected the financial implications of a possible loss of collectable government rent arising from the late completion of the title transfer process.

58. The **Director of Housing** replied at the public hearing and in his letter of 24 May 2011 that:

- the HA sought external legal advice for the divestment exercise. However, as far as the HD could determine, the policy bureaux and

government departments involved relied upon the Government's own internal legal advisors for matters relevant to their particular interest;

- the Executive Council acknowledged that The Link REIT would only be charged government rent once the leases were completed. New leases of land were normally granted subject to payment of government rent. After the leases were granted and the legal title of the RC properties was transferred to The Link REIT, The Link REIT would need to pay government rent in respect of such RC properties. This was clearly explained in the LegCo Brief on "Divestment of HA's RC facilities" issued to the LegCo in July 2003; and
- the valuation of the RC properties covered was clearly intended to ensure that a fair market price was set for all of the properties in question. It was clear from the "Manager's Discussion and Analysis of Future Operations" section of the IPO Circular that The Link REIT would be required to pay government rent for List 1 properties upon divestment and that at a later stage for List 2 properties upon the issue of Government leases and the legal title of the RC properties being transferred to The Link REIT. This showed that this was a factor fully taken into account in the divestment exercise. Indeed, the fact that the leases would be put in place over a number of years following divestment was stated in the documents. The fact that the original intention to complete the exercise by the middle of 2008 was also clearly set out on page 93 of the IPO Circular.

59. In response to the Committee's further enquiries about the valuations of the RC properties sold to The Link REIT, the **Director of Housing** stated in his letter of 30 May 2011, in **Appendix 24**, that the valuations of the divested RC facilities were carried out by an independent property valuer, CB Richard Ellis Limited. The aggregate market value of the divested properties as determined by the property valuer was \$33.802 billion.

60. The Committee enquired whether the Administration had negotiated with The Link REIT for compensating the Government for not being able to charge government rent during the period from mid-2008 to July 2010 due to the late

completion of the transfer process. The **Director of Housing** said at the public hearing and in his letter of 24 May 2011 that:

- given the fact that the obligation to pay the government rent only arose when the Government lease concerned was granted, The Link REIT was not obliged to pay the government rent for those properties with no Government leases and the legal title to which had yet to be transferred to The Link REIT. There was thus no legal basis for the Government to recover from The Link REIT the alleged "notional" government rent chargeable in respect of the properties for the period during which the Government leases were yet to be granted; and
- The Link REIT paid a total lump sum which it was required to pay to the HA in 2005. It was fully understood that the transfer of legal title would be completed subsequently although the transfer took longer time than expected.

61. The Committee referred to paragraph 6.6(a) of the Audit Report, which stated that the HA would look for opportunities to divest the remaining RC facilities and those to be built in the future. However, paragraph 6.7 stated that in December 2009, the Secretary for Transport and Housing said that the HA had no plan to further divest its properties. The Committee asked:

- whether the change of policy was due to the negative comments by the general public on the divestment or obstacles which could not be dealt with; and
- whether the HA and the HD had conducted a post-implementation review on the whole divestment exercise, including the way to divest the properties and the valuation of the RC facilities.

62. The **Director of Housing** replied that:

- there were no particular obstacles to the divestment exercise. The HA had no plan to further divest its properties as it would be a good balance for the HA and the HD to retain some expertise in managing commercial properties. Moreover, the remaining properties were unpopular because of their poor location, small scale, old age or obsolescent conditions. It was anticipated that there would be very little interest for buying any of the remaining properties;

- the process of the 2005 divestment exercise was very transparent and the valuation was discussed in the community at that moment. The approach of the last divestment exercise was considered appropriate; and
- the HD would carry out a post-implementation review of the 2005 divestment exercise to consolidate the experience gained.

Role of the HA as the DMC manager

63. According to paragraphs 6.15 to 6.17 of the Audit Report, the HA has continued to act as the DMC manager for the divested RC facilities in 91 public housing estates. As the DMC manager, the HA is responsible for ensuring that The Link REIT complies with the DMCs and taking necessary measures to enforce the provisions of the DMCs. However, in September 2009, The Link REIT had not yet paid the management fees relating to the "common areas" in the majority of the housing estates for July and August 2009. In addition, LegCo Members had expressed concerns in September 2009 that many recreational facilities managed by The Link REIT had become dilapidated due to improper maintenance and urged the early re-opening of the facilities concerned.

64. The Committee asked about:

- the difficulties encountered by the HA in discharging its responsibilities as the DMC manager; and
- the amount of the outstanding management fees involved and why The Link REIT did not effect payment of the management fees.

65. The **Deputy Director (Estate Management)** said at the public hearing and the **Director of Housing** stated in his letter of 16 May 2011 that:

- the HD had been closely monitoring the work of The Link REIT to ensure its compliance with DMC and lease conditions. At present, except one recreational facility for which repairing works was still in progress, all recreational facilities concerned had been re-opened; and
- The Link REIT failed to effect payment of the management fees for July and August 2009 as there had been arguments on the amount of the management fees that it should pay, which was around \$8 million. The

Link REIT had settled all the management fees in arrears in mid-September 2009.

E. Conclusions and recommendations

66. The Committee:

Management of retail premises

Day-to-day management of retail premises

- is surprised and regrets to note that the Housing Department ("HD")'s day-to-day management of the Hong Kong Housing Authority ("HA")'s retail premises is lax and ineffective, and the problems are attributable partly to the failure of staff of the HD and property management contractors to vigilantly follow the HD's set instructions and guidelines over the years, and partly to the HD management's failure to provide proper guidance to its staff (and contractor staff) on the conduct of inspection of retail premises and to deploy adequate manpower for the management of retail premises, as reflected by the following:
 - (a) the HD had deployed only 16 senior managers to oversee the management of about 180 housing estates, which may not be adequate for effectively supervising HD frontline staff and contractors in properly carrying out the inspection of retail premises;
 - (b) suspected gambling activities appear to be common occurrences in some retail premises. Although the HD issued an internal instruction in January 1997 requiring all estate housing managers to take various measures to deal with gambling activities, HD staff (and contractor staff) have failed to follow through the measures laid down in the instruction, as illustrated by the incidents mentioned in paragraph 2.14 of the Director of Audit's Report ("Audit Report");
 - (c) although HD frontline staff (or security guards) are required to conduct daily patrols of retail premises to ensure the proper use and prompt maintenance of the premises, and to monitor tenants' performance under the marking scheme, and the HD has implemented a unit-to-unit inspection regime on all retail premises

since July 2010, there are still cases of improper use and unauthorised alteration of retail premises (including storerooms);

- (d) the HD's unit-to-unit inspection regime did not cover storerooms, and no guideline had been issued to HD staff (or contractor staff) to advise them to inspect the high-risk cases, such as repeated offenders and premises not regularly open for business, with a higher priority and frequency within the 18-month cycle period under the unit-to-unit inspection regime; and
 - (e) although a marking scheme has been implemented in HA retail premises since October 2006 and causing obstruction in public areas is one of the scheduled misdeeds under the scheme, the problem of obstruction in public areas is still common and some tenants repeatedly committed the misdeed. The Audit Commission ("Audit") found that there were instances of not allotting penalty points even after written warnings had been issued on the same misdeeds, and instances of not updating the records in the information system on marking scheme by HD staff and contractors after the issue of written warnings or allotment of penalty points;
- expresses concern that some let-out retail premises of HA retail facilities are not open for business (i.e. non-trading) during normal business hours. However, there is no provision in the HA's tenancy agreements that requires retail shops and cooked food stalls to open for business for any minimum hours per day or minimum days per week, and the "non-trading rule" in the HA's tenancy agreements for market stalls is less stringent than that stipulated by the Food and Environmental Hygiene Department ("FEHD"). The prevalence of non-trading retail premises is not conducive to achieving the HA's objective of enhancing residents' quality of life through the provision of retail, commercial and social facilities. There is also a risk that some premises, when not opened for business, might be used for purposes other than those specified in the tenancy agreements;
 - acknowledges that:
 - (a) the HD has investigated into individual suspected cases identified by Audit and taken tenancy enforcement actions where appropriate;

- (b) the HD has issued a new internal instruction to provide detailed guidelines advising HD/contractor staff to step up the unit-to-unit inspections according to the prescribed priority and the frequency based on the high-risk categories such as repeated offenders and non-trading retail premises;
 - (c) the HD will report all suspected gambling activities to the police and, in case of conviction, take tenancy enforcement actions including issuance of notice-to-quit;
 - (d) the HD will review the feasibility to specify opening hours in tenancy agreements appropriate to the nature of business and customer demand in respect of the retail facilities, having regard to the best interest of the domestic tenants; and
 - (e) the Director of Housing has agreed with the audit recommendations in paragraph 2.20 of the Audit Report;
- urges the Director of Housing to:
- (a) review the adequacy of manpower deployed for overseeing the management of retail premises, so as to effectively supervise HD frontline staff and contractors in properly carrying out the inspection of retail premises, and strengthen the manpower where appropriate;
 - (b) take measures to ensure that HD staff and contractors will strictly follow through the measures set out in the internal instruction of January 1997 to deal with gambling activities;
 - (c) consider modifying the existing marking scheme to cover improper and unauthorised use of retail premises, such as gambling; and
 - (d) take prompt action to tighten the "non-trading rule" for HA market stalls, having regard to the FEHD's practice;

Letting of retail premises and implementation of improvement measures

- regrets that many HA retail premises have remained vacant for a long time. Of the 251 vacant retail premises which were available for letting as at December 2010, 122 (49%) had been vacant for over three years. Although the HD has taken improvement measures in recent

years in some markets, their effectiveness is yet to be seen as the market vacancy rates have remained high;

- recognises that the long vacant retail premises are often located in older public housing estates and unpopular locations, but regrets that the HD had taken neither effective measures to let out those retail shops nor prompt actions to explore viable options to optimise their use, leading to a waste of public resources, as follows:
 - (a) the HD had not taken adequate measures to ensure that these vacant premises are widely publicised and put up for open tender as frequently as practicable;
 - (b) for vacant premises which did not attract any bidder in an open tender, the HD would normally take quite a long time (about two calendar months) to re-tender the same premises. As a result, if an open tender for letting out a retail premises is unsuccessful, the same premises will remain vacant for at least another two months before procedures for re-tendering could be completed;
 - (c) a vacant retail shop in Wah Fu (II) Estate had been repeatedly re-designated for different trades, some of which were very similar, based on the HD staff's own knowledge and experience in over 25 unsuccessful re-tendering exercises since 2004. This reflects that the HD staff concerned had only conducted the re-tendering exercises as a matter of routine without analysing the reasons why the shop had not attracted any bidders, so as to identify effective ways to let out the shop, and market research had not been conducted to ascertain the latest retail trend and actual demand for the vacant shop; and
 - (d) the factors taken into account by the HD in setting the priority for major improvement works do not include vacancy rates of the retail facilities concerned;
- acknowledges that:
 - (a) the HD has taken initiatives to optimise the use of surplus retail facilities and reduce vacancy rates through conversion to other uses to suit residents' need, and market re-ordering exercise;

- (b) the HD has, as approved by the Commercial Properties Committee ("CPC"), earmarked the retail facilities at Wah Fu (II) Estate for early consideration of major improvement works to enhance their commercial potential; and
- (c) the Director of Housing has agreed with the audit recommendations in paragraphs 2.30 and 2.40 of the Audit Report;
- urges the Director of Housing to:
 - (a) conduct market research to ascertain the actual demand for long vacant retail premises, and proactively explore options to optimise the use of the premises having regard to the actual demand, e.g. letting out the premises to welfare organisations/arts groups, or converting them to other gainful uses such as library or students' study room; and
 - (b) expeditiously carry out major improvement works for the retail facilities at Wah Fu (II) Estate to enhance their commercial potential;

Monitoring of operating expenditure

- expresses concern that in 2009-2010, the operating expenditure for many retail facilities exceeded the HD's benchmarks. Some estate housing managers had not fully reported the non-compliance to the senior management, nor had they proposed adequate follow-up action to control the expenditure;
- acknowledges that:
 - (a) the HD will conduct periodic reviews on operating expenditure, and has provided specific training courses to local management staff on accounting guidelines and charging principles for business accounts; and
 - (b) the Director of Housing has agreed with the audit recommendations in paragraph 2.48 of the Audit Report;
- urges the Director of Housing to implement the above audit recommendations expeditiously;

Management of car parks

- expresses concern that:
 - (a) the provision of public housing carpark facilities had turned out to be greater than the actual demand for many aged estates. This has led to surplus provision of parking spaces and high vacancy rates in these HA car parks, resulting in under-utilisation of valuable resources;
 - (b) despite the HD's efforts in recent years to improve the utilisation of car parks, in December 2010, 46 (39%) of the 117 HA car parks still had a low occupancy rate of below 70%;
 - (c) for Project 3 relating to leasing part of a car park to Organisation C for operating a telephone transaction centre cum volunteers and training centre, although it was a commercial letting according to HD records, the rent charged was on a par with the concessionary rent normally applicable for welfare lettings. This was contrary to the HD's established practice of charging market rent for commercial lettings;
 - (d) although the HD had informed the HA's CPC that conversion works for Project 3 would commence only after Organisation C had signed and accepted the HA's letter of offer, the HD started the works more than two months before the signing of the letter of offer; and
 - (e) although the HD's internal instruction stipulates that a tenant is not allowed to move into the premises unless the tenancy agreement has been executed, the HD started to hand over the premises to Organisation C more than two years before its signing of the tenancy agreement;
- acknowledges that:
 - (a) substantial revisions to the parking standards for public housing developments have been made since 2009. The HD has, in consultation with the Transport Department, refined the planning standards of parking spaces, and will continue to carefully plan the provision of parking facilities appropriate to new public housing developments on a case-by-case basis;

- (b) while a five-year programme for carpark improvement will be rolled out, the HD will implement short-term measures such as change of use of parking spaces (e.g. change from private car to motorcycle parking spaces) and letting to non-residents to improve occupancy rates;
 - (c) the Director of Housing considered that Project 3 was a very special case. The HD will continue the practice of making rent assessment for other major conversion projects;
 - (d) the Director of Housing has agreed with the audit recommendations in paragraphs 3.12, 3.21 and 3.34 of the Audit Report; and
 - (e) the Commissioner for Transport has agreed with the audit recommendation in paragraph 3.12 of the Audit Report;
- urges the Director of Housing to take effective actions to implement the above audit recommendations;

Management of factory estates

- is disappointed that:
 - (a) the HD had not formulated an effective strategy to implement the HA's 1989 policy of absolving itself from the ownership and management of factory estates in the long term during the past 21 years, and it was only after the matter was raised by Audit that the HD sought the CPC's approval in April 2011 to modify the HA's policy whereby the HD would continue managing the six newer factory estates *pro tem* and review the situation from time to time; and
 - (b) the HD's procedures for detecting subletting or unauthorised use of factory premises were not properly followed in the two factory estates visited by Audit, and there were cases of unauthorised subletting of factory premises;
- acknowledges that:
 - (a) in March 2011, the CPC approved a plan to clear the Chai Wan Factory Estate. The HA considers that the site is suitable for

public rental housing development and intends to seek its allocation for that purpose;

- (b) the Director of Housing has undertaken to inform the Legislative Council ("LegCo") if there is a substantial change to the long-term policy on the ownership and management of the six newer factory estates in future;
 - (c) the HD has investigated into each suspected subletting case and taken necessary actions to rectify the problem; and
 - (d) the Director of Housing has agreed with the audit recommendations in paragraphs 4.11, 4.16 and 4.28 of the Audit Report;
- urges the Director of Housing to promptly inform the LegCo if there is a further change to the policy on the ownership and management of the six newer factory estates;

Performance measurement and reporting

- expresses concern that:
 - (a) the HD had not properly calculated the vacancy rates of retail premises for reporting to the CPC, as detailed in paragraphs 5.5 to 5.7 of the Audit Report;
 - (b) the HD did not systematically collect feedback on the residents' satisfaction level on performance in various aspects of the management of commercial properties; and
 - (c) apart from retail premises, there are no key performance indicators ("KPIs")/targets to measure the vacancy position of other types of properties (i.e. car parks, factory estates and welfare premises);
- acknowledges that:
 - (a) the HD will exclude all new premises, which are not yet ready for letting, from the total stock in calculating the vacancy rates, and will revisit the approach in reporting the vacancy rate of different categories of non-domestic premises;

- (b) the HD will extend the scope of its annual Public Housing Recurrent Survey to cover residents' satisfaction level on management of HA commercial properties, and closely monitor the survey findings for benchmarking purpose;
 - (c) the HD will consider the audit recommendation of setting specific KPIs and targets (e.g. vacancy rate) for different types of commercial properties in the forthcoming 2012-2013 business plan for commercial properties; and
 - (d) the Director of Housing has agreed with the audit recommendations in paragraph 5.12 of the Audit Report;
- urges the Director of Housing to implement the above audit recommendations without delay;

The way forward

- notes that:
 - (a) one of the reasons for the divestment of the HA's retail and carpark facilities was that with the cessation of construction and sale of Home Ownership Scheme flats, the HA lacked a recurrent source of income. Proceeds from the divestment would help the HA meet its funding requirements in the short term; and
 - (b) at the time when The Link Real Estate Investment Trust ("The Link REIT") was listed in 2005, the HA could only transfer to it the legal title of 76 divested properties;
- regrets that:
 - (a) although it was intended that the legal title of the remaining 104 divested properties would be transferred to The Link REIT in batches by mid-2008, there were 54 divested properties the legal title of which could only be transferred to The Link REIT after mid-2008. The late completion of the transfer had deprived the Government of the right to charge government rent on the divested properties during the period from mid-2008 to July 2010, resulting in a loss amounted to some \$30 million;

- (b) the Administration had not before the listing of The Link REIT conducted a comprehensive risk assessment, from the perspective of the Government and the taxpayers, of the delay in transfer of legal title and take effective measures to protect the Government from the loss of collectable rent. For example, although the Administration was fully aware that The Link REIT would only be required to pay government rent for the 104 properties upon transfer of their legal title at a later stage (i.e. by mid-2008), it failed to make alternative arrangements to cater for a delay in completing the transfer, such as by requiring The Link REIT to make a lump sum payment or periodical payments for the properties concerned to cover the government rent for the period before completion of the transfer. Besides, the Panel on Housing of the LegCo had not been apprised of the possible loss of government income due to the delay in completing the transfer of the legal title of the properties; and
 - (c) various issues have arisen from the 2005 divestment exercise, as detailed in paragraphs 6.8 to 6.20 of the Audit Report. However, the HA has not conducted a post-implementation review to consolidate the experience gained from the divestment exercise;
- acknowledges that:
- (a) although the HA has no plan to further divest its retail and carpark facilities at this stage, it will conduct a post-implementation review of the 2005 divestment exercise;
 - (b) the Director of Housing has agreed with the audit recommendations in paragraph 6.26 of the Audit Report; and
 - (c) the Secretary for Financial Services and the Treasury has agreed with the audit recommendations in paragraph 6.26(c) and (d) of the Audit Report;
- urges the Administration and the HA to learn the lessons from the 2005 divestment exercise and critically assess all the financial implications of any delay in transferring the legal title of the divested properties and make alternative arrangements to safeguard the Government's income, when planning a divestment exercise in the future;

- urges the Director of Housing to conduct a post-implementation review of the 2005 divestment exercise expeditiously and inform the LegCo of the outcome of the review; and

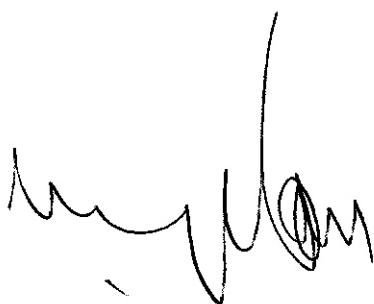
Follow-up action

- wishes to be kept informed of the progress made in implementing the various recommendations made by the Committee and Audit.

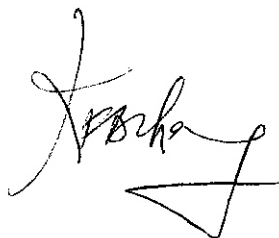
**SIGNATURES OF THE CHAIRMAN,
DEPUTY CHAIRMAN AND MEMBERS OF THE COMMITTEE**



Philip WONG Yu-hong
(Chairman)



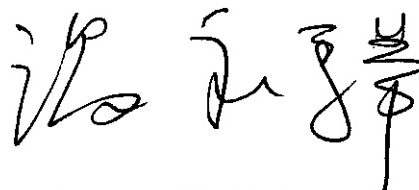
Paul CHAN Mo-po
(Deputy Chairman)



Andrew CHENG Kar-foo



Abraham SHEK Lai-him



Ronny TONG Ka-wah



Cyd HO Sau-lan



Starry LEE Wai-king

21 June 2011

**CHAPTERS IN THE DIRECTOR OF AUDIT'S REPORT NO. 56
DEALT WITH IN THE PUBLIC ACCOUNTS COMMITTEE'S REPORT**

Director of Audit's Report No. 56		P.A.C. Report No. 56
<u>Chapter</u>	<u>Subject</u>	<u>Chapter</u>
5	Hong Kong 2009 East Asian Games	1
6	Hong Kong Export Credit Insurance Corporation	2
7	Hong Kong Housing Authority: Management of commercial properties	3

**RULES OF PROCEDURE OF
THE LEGISLATIVE COUNCIL OF
THE HONG KONG SPECIAL ADMINISTRATIVE REGION**

72. Public Accounts Committee

(1) There shall be a standing committee, to be called the Public Accounts Committee, to consider reports of the Director of Audit –

- (a) on the accounts of the Government;
- (b) on such other accounts required to be laid before the Council as the committee may think fit; and
- (c) on any matter incidental to the performance of his duties or the exercise of his powers as the committee may think fit.

(2) The committee shall also consider any report of the Director of Audit laid on the Table of the Council which deals with examinations (value for money audit) carried out by the Director relating to the economy, efficiency and effectiveness of any Government department or public body or any organization to which his functions as Director of Audit extend by virtue of any Ordinance or which receives public moneys by way of subvention.

(3) The committee shall consist of a chairman, deputy chairman and 5 members who shall be Members appointed by the President in accordance with an election procedure determined by the House Committee. *(L.N. 214 of 2005)*

(3A) The chairman and 2 other members shall constitute a quorum of the committee. *(L.N. 214 of 2005)*

(3B) In the event of the temporary absence of the chairman and deputy chairman, the committee may elect a chairman to act during such absence. *(L.N. 214 of 2005)*

(3C) All matters before the committee shall be decided by a majority of the members voting. Neither the chairman nor any other member presiding shall vote, unless the votes of the other members are equally divided, in which case he shall give a casting vote. *(L.N. 214 of 2005)*

(4) A report mentioned in subrules (1) and (2) shall be deemed to have been referred by the Council to the committee when it is laid on the Table of the Council.

(5) Unless the chairman otherwise orders, members of the press and of the public shall be admitted as spectators at meetings of the committee attended by any person invited by the committee under subrule (8).

(6) The committee shall meet at the time and the place determined by the chairman. Written notice of every meeting shall be given to the members and to any person invited to attend a meeting at least 5 clear days before the day of the meeting but shorter notice may be given in any case where the chairman so directs.

(7) *(Repealed L.N. 214 of 2005)*

(8) The chairman or the committee may invite any public officer, or, in the case of a report on the accounts of or relating to a non-government body or organization, any member or employee of that body or organization, to give information or any explanation or to produce any records or documents which the committee may require in the performance of its duties; and the committee may also invite any other person to assist the committee in relation to any such information, explanation, records or documents.

(9) The committee shall make their report upon the report of the Director of Audit on the accounts of the Government within 3 months (or such longer period as may be determined under section 12 of the Audit Ordinance (Cap. 122)) of the date on which the Director's report is laid on the Table of the Council.

(10) The committee shall make their report upon the report of the Director of Audit mentioned in subrule (2) within 3 months (or such longer period as may be determined by the Council) of the date on which the Director's report is laid on the Table of the Council.

(11) Subject to these Rules of Procedure, the practice and procedure of the committee shall be determined by the committee.

**Paper presented to the Provisional Legislative Council
by the Chairman of the Public Accounts Committee
at the meeting on 11 February 1998 on
Scope of Government Audit in the
Hong Kong Special Administrative Region -
'Value for Money Audits'**

SCOPE OF WORK

1. The Director of Audit may carry out examinations into the economy, efficiency and effectiveness with which any bureau, department, agency, other public body, public office, or audited organisation has discharged its functions.
2. The term "audited organisation" shall include -
 - (i) any person, body corporate or other body whose accounts the Director of Audit is empowered under any Ordinance to audit;
 - (ii) any organisation which receives more than half its income from public moneys (this should not preclude the Director from carrying out similar examinations in any organisation which receives less than half its income from public moneys by virtue of an agreement made as a condition of subvention); and
 - (iii) any organisation the accounts and records of which the Director is authorised in writing by the Chief Executive to audit in the public interest under section 15 of the Audit Ordinance (Cap. 122).
3. This definition of scope of work shall not be construed as entitling the Director of Audit to question the merits of the policy objectives of any bureau, department, agency, other public body, public office, or audited organisation in respect of which an examination is being carried out or, subject to the following Guidelines, the methods by which such policy objectives have been sought, but he may question the economy, efficiency and effectiveness of the means used to achieve them.

GUIDELINES

4. The Director of Audit should have great freedom in presenting his reports to the Legislative Council. He may draw attention to any circumstance which comes to his knowledge in the course of audit, and point out its financial implications. Subject to these Guidelines, he will not comment on policy decisions of the Executive Council and the Legislative Council, save from the point of view of their effect on the public purse.

5. In the event that the Director of Audit, during the course of carrying out an examination into the implementation of policy objectives, reasonably believes that at the time policy objectives were set and decisions made there may have been a lack of sufficient, relevant and reliable financial and other data available upon which to set such policy objectives or to make such decisions, and that critical underlying assumptions may not have been made explicit, he may carry out an investigation as to whether that belief is well founded. If it appears to be so, he should bring the matter to the attention of the Legislative Council with a view to further inquiry by the Public Accounts Committee. As such an investigation may involve consideration of the methods by which policy objectives have been sought, the Director should, in his report to the Legislative Council on the matter in question, not make any judgement on the issue, but rather present facts upon which the Public Accounts Committee may make inquiry.

6. The Director of Audit may also -

- (i) consider as to whether policy objectives have been determined, and policy decisions taken, with appropriate authority;
- (ii) consider whether there are satisfactory arrangements for considering alternative options in the implementation of policy, including the identification, selection and evaluation of such options;
- (iii) consider as to whether established policy aims and objectives have been clearly set out; whether subsequent decisions on the implementation of policy are consistent with the approved aims and objectives, and have been taken with proper authority at the appropriate level; and whether the resultant instructions to staff accord with the approved policy aims and decisions and are clearly understood by those concerned;

- (iv) consider as to whether there is conflict or potential conflict between different policy aims or objectives, or between the means chosen to implement them;
- (v) consider how far, and how effectively, policy aims and objectives have been translated into operational targets and measures of performance and whether the costs of alternative levels of service and other relevant factors have been considered, and are reviewed as costs change; and
- (vi) be entitled to exercise the powers given to him under section 9 of the Audit Ordinance (Cap. 122).

PROCEDURES

7. The Director of Audit shall report his findings on value for money audits in the Legislative Council twice each year. The first report shall be submitted to the President of the Legislative Council within seven months of the end of the financial year, or such longer period as the Chief Executive may determine. Within one month, or such longer period as the President may determine, copies shall be laid before the Legislative Council. The second report shall be submitted to the President of the Legislative Council by the 7th of April each year, or such date as the Chief Executive may determine. By the 30th April, or such date as the President may determine, copies shall be laid before the Legislative Council.

8. The Director's report shall be referred to the Public Accounts Committee for consideration when it is laid on the table of the Legislative Council. The Public Accounts Committee shall follow the rules governing the procedures of the Legislative Council in considering the Director's reports.

9. A Government minute commenting on the action Government proposes to take in respect of the Public Accounts Committee's report shall be laid on the table of the Legislative Council within three months of the laying of the report of the Committee to which it relates.

10. In this paper, reference to the Legislative Council shall, during the existence of the Provisional Legislative Council, be construed as the Provisional Legislative Council.

**Witnesses who appeared before the Committee
(in order of appearance)**

Mr TSANG Tak-sing	Secretary for Home Affairs
Mr Jonathan McKINLEY	Deputy Secretary for Home Affairs (2)
Mrs Betty FUNG	Director of Leisure and Cultural Services
Mr Bobby CHENG	Deputy Director of Leisure and Cultural Services (Leisure Services)
Miss Olivia CHAN	Assistant Director (Leisure Services) 2 Leisure and Cultural Services Department
Ms Julia LEUNG	Acting Secretary for Financial Services and the Treasury
Mr Stanley YING	Permanent Secretary for Financial Services and the Treasury (Treasury)
Hon Timothy FOK Tsun-ting	President Sports Federation and Olympic Committee of Hong Kong, China
Mr Johnny WOO	Former Chief Executive Officer 2009 East Asian Games (Hong Kong) Limited
Mr Benjamin MOK	Principal Assistant Secretary for Home Affairs (Recreation and Sport)
Dr Andrew CHAN Ping-chiu	Chairman, Commercial Properties Committee Hong Kong Housing Authority
Mr D W PESCOD	Director of Housing
Mr LEE Kwok-wing	Deputy Director (Estate Management) Housing Department
Mr LIU King-leung	Assistant Director (Estate Management) 3 Housing Department

Miss Rosaline WONG Lai-ping	Chief Estate Surveyor (Commercial Properties) Housing Department
Mr Allan WONG Nai-kwong	Chief Manager/Management (Kwai Chung) Housing Department
Mr Sunny IP Yu-sun	Chief Manager/Management (Kowloon West & Hong Kong) Housing Department

**Introductory Remarks by the
Chairman of the Public Accounts Committee,
Dr Hon Philip WONG Yu-hong, GBS,
at the First Public Hearing of the Committee
in respect of the Director of Audit's Report No. 56
on Thursday, 5 May 2011**

Good morning, ladies and gentlemen. Welcome to the Public Accounts Committee's public hearing relating to Report No. 56 of the Director of Audit on the results of value for money audits, which was tabled in the Legislative Council on 13 April 2011.

2. The Public Accounts Committee is a standing committee of the Legislative Council. It plays the role of a watchdog over public expenditure through consideration of the reports of the Director of Audit laid before the Council on the Government's accounts and the results of value for money audits of the Government and those organisations which receive funding from the Government. The consideration by the Committee of the Director's reports involves gathering evidence relevant to the facts contained in the Director's reports, so that the Committee may draw conclusions and make recommendations in a constructive spirit and forward-looking manner. I also wish to stress that the objective of the whole exercise is such that the lessons learned from past experience and our comments on the performance of the public officers or other personnel concerned will enable the Government to improve its control over the expenditure of public funds, with due regard to economy, efficiency and effectiveness.

3. The consideration of the Director's reports follows an established process of public hearings where necessary, internal deliberations and publication of the Committee's report. The Committee has an established procedure for ensuring that the parties concerned have a reasonable opportunity to be heard. After the Committee is satisfied that it has ascertained the relevant facts, it will proceed to form its views on those facts, followed by a process of formulating its conclusions and recommendations to be included in its report. In accordance with Rule 72 of the Rules of Procedure of the Legislative Council, the Committee is required to make its report on the Director's report to the Legislative Council within three months of the date at which the Director's report is laid on the Table of the Council. Before then, we will not, as a committee or individually, be making any public comments.

4. Following a preliminary study of Report No. 56, the Committee has decided, in respect of two chapters in the Report, to invite the relevant public officers and other personnel concerned to appear before the Committee and answer our questions. We have, apart from this morning's hearing, also set aside 12 May 2011 for public hearing on the other chapter.

5. The public hearing this morning is on Chapter 5 of Report No. 56 on the subject of "Hong Kong 2009 East Asian Games". The witnesses are: Mr TSANG Tak-sing (Secretary for Home Affairs), Mr Jonathan McKINLEY (Deputy Secretary for Home Affairs), Mrs Betty FUNG (Director of Leisure and Cultural Services), Mr Bobby CHENG (Deputy Director of Leisure and Cultural Services (Leisure Services)), Miss Olivia CHAN (Assistant Director (Leisure Services)), Ms Julia LEUNG (Acting Secretary for Financial Services and the Treasury), Mr Stanley YING (Permanent Secretary for Financial Services and the Treasury (Treasury)), Hon Timothy FOK Tsun-ting (President of the Sports Federation and Olympic Committee of Hong Kong, China) and Mr Johnny WOO (Former Chief Executive Officer of the 2009 East Asian Games (Hong Kong) Limited).

6. Please note that except for designated public officers, other persons are not covered by the protection and immunity provided under the Legislative Council (Powers and Privileges) Ordinance (Cap. 382) when addressing the Committee.

7. I now invite members to ask questions.

**Remarks of the Secretary for Home Affairs on
Chapter 5 of the Director of Audit's Report No. 56
Hong Kong 2009 East Asian Games
at the Public Accounts Committee of the Legislative Council
on 5 May 2011**

Chairman,

I welcome this hearing convened by the Public Accounts Committee. It offers us an opportunity to explain the accounts and related facts about the East Asian Games (EAG). My colleagues and I are prepared to answer any questions Members may have. I would like to provide some information first to facilitate discussion.

The EAG was the first major international multi-sports event held in Hong Kong. We won the bid in 2003 to host the EAG and staged the event in late 2009. We carried through the project which spanned six years and involved two terms of the HKSAR Government. As you will remember, when we were bidding to host the EAG in 2003, the Hong Kong economy had yet to recover from the damage resulting from the outbreak of the Severe Acute Respiratory Syndrome (SARS). As such, we sought in principle approval from the Finance Committee (FC) of the Legislative Council for an estimated government commitment of only \$84 million for staging the EAG. When we sought funding support from the FC for the operating cost of the EAG in January 2006, the government commitment was revised to \$123 million, about half of the total estimated operating expenditure for the EAG (51%) [The estimated expenditure and revenue were \$240 million and \$117 million respectively]. The current SAR Government took measures to ensure that the allocation of \$123 million approved by the FC for the EAG would not be exceeded. The measures included economising on expenditure and generating income from various sources like sponsorship and other forms of support. The Home Affairs Bureau and the Leisure and Cultural Services Department (LCSD) worked closely with the EAG Company and urged the Company to adopt a prudent approach in financial management, and to live within its means. In the event, the EAG Company was not just able to balance its books, it even recorded a surplus for returning to the Government. The actual

balance borne by the Government was just about \$110 million, or 38% of the total operating expenditure for the EAG.

With the EAG drawing to a close in late 2009, the majority view of the community was that the EAG was successful – and this conclusion still stands as we review it again today. The EAG’s success could be attributed to the participation and support of different sectors of the community - the sports sector, members of various government departments, medical and healthcare personnel, young people and a great number of volunteers – all of whom took part in and contributed to the event. I know that the teams involved in the organisation of the EAG worked day and night before and after the opening of the EAG. Once again, I would like to express my heartfelt thanks to all those who contributed to the staging of the EAG!

After the event, I received commendations from many participating delegations. Count Jacques Rogge, President of the International Olympic Committee, after attending the EAG opening ceremony at the Tsim Sha Tsui harbourfront praised the creativity and effect of the ceremony, saying that it deserved a gold medal. An article issued by the Xinhua News Agency noted that the 2009 EAG had been successful despite a limited budget which was no match for those of other multi-sports events or even certain high-level single sports competitions. The success of the 2009 EAG showcased the concept behind the “Hong Kong approach” of organising the event from which future organisers may draw reference, namely: frugality, pragmatism and innovation.

This was the first time that Hong Kong had hosted such a major international multi-sports event, and so we did not expect every aspect of the event to be perfect or flawless. We built in a mechanism to promptly address and respond to problems identified. Reviews were conducted after the EAG. Noting the public enthusiasm for sport after the event, we have pressed ahead with measures to promote sport in Hong Kong, including the implementation of reform packages to develop football, the promotion of “sport for all”, the development of elite sport and the positioning of Hong Kong as a centre for international sports events. The SAR Government is also

planning to inject \$7 billion to support the Hong Kong Sports Institute in nurturing elite athletes. I shall not go into details of the proposed injection here, as we will report to the Home Affairs Panel on this subject in due course.

We will also draw on the practical experience gained from the EAG when organising similar events in future. I would like to highlight the following points:

First, the approach of setting up a company to be responsible for the operation of a multi-sports event was entirely appropriate. However, the coordination and support of many government departments were still indispensable. Major international multi-sports events, including the EAG, are owned by their respective international sports organisations (e.g., the International Olympic Committee, Olympic Council of Asia or EAG Association) and the National Olympic Committee of the hosting country or region. The setting up of an independent company to oversee the operation of the event provides a platform for cooperation between the sports organisations and the government. This approach caters for the specific requirements of sports events, and also provides necessary efficiency and transparency. The EAG Company was a registered entity subject to the regulation of the Companies Ordinance. Its audited annual accounts had to be confirmed by its Board of Directors before submission to the Companies Registry. As a matter of fact, the audited annual financial statements of the EAG Company as at 31 March 2011 were submitted to the Companies Registry in July last year and can be inspected by the public. Meanwhile, the Government has the responsibility to provide support and other logistical services for any large-scale international event – not just sports events – held in Hong Kong. The responsibilities of the HKSAR Government in relation to the organisation of the EAG were clearly stated in the Tripartite Agreement signed between the Government, the Sports Federation and Olympic Committee of Hong Kong, China (SF&OC) and the EAG Company. Different government departments have stepped up the services under their respective purviews in support of the EAG. The additional costs incurred were absorbed by these departments.

Second, venues and facilities are required for the hosting of major sports events. However, it is important to strike a balance between building sports venues that are suitable for competitions only and those that are also suitable for use by members of the public. As such, in allocating resources for the provision of venues, the Government included costs both for constructing the venues and for providing temporary overlay to such venues to make them suitable for competition use. This temporary overlay included, for instance, the installation of spectator stands, prize presentation platforms and thematic designs. In so far as the staging of the EAG was concerned, the necessary cost for temporary overlay was incorporated into the total capital cost that was submitted by the Government of the previous term to the FC for approval in one go in 2007. Based on the experience gained from the EAG, in the public consultation document issued in 2010 for the bid for hosting the 2023 Asian Games, we indicated the estimated project cost for temporary overlay as a separate item to give the public a clearer picture.

Third, the SF&OC and the “national sports associations” (NSAs) have to be close partners of the Government in the hosting of multi-sports events. NSAs’ specialised knowledge in venue planning, competition scheduling and judging criteria, and their commitment are essential. The unity of the sports sector and the governance of sports organisations are therefore vital to the promotion of sports development and the success of large-scale sports events. Last January, the LCSD set up a steering committee to carry out a comprehensive review of the existing subvention scheme for NSAs. It has started launching a series of measures to help NSAs enhance their corporate governance and internal control in 2011-12. All these measures should have a positive impact on our work in future, and will facilitate cooperation among various parties in the organisation of large-scale sports events.

Lastly, I would like to comment on the liquidation of the EAG Company. I know that the Company formally entered the liquidation stage on 1 July 2010, after its last Board of Directors meeting held on 24 June 2010. After that, the liquidator had to arrange for gazetting of the liquidation, and to handle the remaining accounts receivable and payable. In the process, the liquidator also had to deal with some

belated claims made to the Company. In early April this year, the Company's liquidator and auditors completed the financial statements in relation to the last three months of the Company's operation (i.e., from April to June 2010). These statements have been submitted to the Inland Revenue Department (IRD) for tax assessment. After obtaining a notice of clearance from the IRD, the balance can be returned to the Government. It is expected that the above-mentioned work will be completed within the next two months.

The Committee is invited to note the above information. Thank you, Chairman.

財 經 事 務 及 庫 務 局
(庫 務 科)

香 港 下 亞 厘 畢 道
中 區 政 府 合 署



**FINANCIAL SERVICES AND THE
TREASURY BUREAU
(The Treasury Branch)**

Central Government Offices,
Lower Albert Road,
Hong Kong

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電話號碼 Tel. No. : 2810 2283
本函檔號 Our Ref. : TsyB C 285/520-1/2/0 (C) Pt 2
來函檔號 Your Ref. : CB(4)/PAC/R56

13 May 2011

(By Fax: 2840 0716)

Ms Miranda HON
Clerk, Public Accounts Committee
Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Ms Hon,

**The Director of Audit's Report on the
results of value of money audits (Report No. 56)**

Hong Kong 2009 East Asian Games (Chapter 5)

I refer to your letter of 9 May 2011 requesting a copy of our original response to the Audit Commission relating to paragraph 3.28 of the Audit Report.

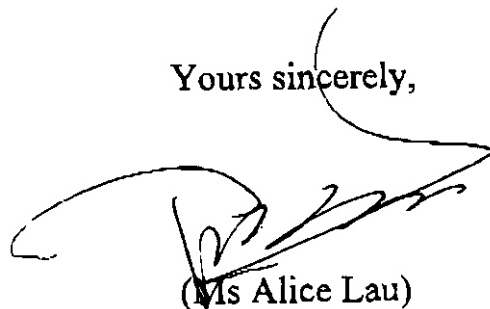
The full text of our original response to the Audit Commission is appended below -

“We understand that Audit's main concerns are whether the original estimates for the 2009 EAG were accurate and whether the full financial implications of the event were

adequately disclosed. We wish to point out that apart from those bureau/departments listed in Table 2 of the report, several other departments, such as the Hong Kong Police Force, Transport Department, etc. had also incurred expenditure under their departmental votes to support the hosting the 2009 EAG in Hong Kong by enhancing services that they provided as part of their day-to-day responsibilities. We expect these departments would have done the same had the event been any other that was of a scale that required an enhanced level of service. While one may regard the expenditure incurred by such departments as part of the overall financial implications of hosting the EAG, the expenditure are quite different from “direct expenditures” such as those incurred by the EAG Company in enabling the hosting of the EAG. We therefore suggest that all expenditure incurred by supporting departments, including but not limited to the expenditure incurred by LCSD, HAB, ISD and HAD as set out in Table 2, be regarded as “other expenditure” for support the hosting of the EAG where appropriate”.

At the hearings we have in response to Members’ questions elaborated on our analyses in connection with the matter discussed in the above exchanges and other related issues.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Ms Alice Lau', written over a horizontal line.

(Ms Alice Lau)
for Secretary for Financial Services
and the Treasury

c.c. Director of Audit (Fax no: 2583 9063)
Secretary for Home Affairs (Fax no: 2840 1902)
Permanent Secretary for Home Affairs (Fax no: 2832 9983)
Director of Leisure and Cultural Services (Fax no: 2606 1824)

政府總部
民政事務局

香港灣仔
告士打道五號
稅務大樓
四十一樓



GOVERNMENT SECRETARIAT

HOME AFFAIRS BUREAU

41/F, REVENUE TOWER
5 GLOUCESTER ROAD
WAN CHAI
HONG KONG

本署檔號 Our Ref :
來函檔號 Your Ref: CB4/PAC/R56

電話 Tel : 2594 5644
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24 May 2011

Ms Miranda HON
Clerk, Public Accounts Committee
Legislative Council Building,
8 Jackson Road,
Central, Hong Kong

Dear Ms HON

**The Director of Audit's Report on the
results of value for money audits (Report No. 56)**

Hong Kong 2009 East Asian Games (Chapter 5)

I refer to your letter of 12 May 2011 requesting further information on the Hong Kong 2009 East Asian Games (EAG). The required information is set out below -

(a) Ranks and salaries of government staff

The ranks and monthly salaries of the 80 government staff deployed by LCSD from 2006-2007 to 2010-2011 to provide support for the 2009 EAG are set out at **Annex A**.

(b) Accounting treatment

The accounting treatments for the recognition of sponsorships and government grant reflected the progress in delivering the EAG as well as the EAG Company's accounting policy and the actual funding situation. The detailed arrangements are set out in **Annex B**. The accounting arrangement has been consistently applied

throughout the financial years concerned. All deferred income from both government grant and sponsorships was recognised upon the conclusion of EAG.

(c) Broadcasting and television rights

When the Government sought the in-principle support of the Finance Committee (FC) of the Legislative Council (LegCo) in July 2003 for Hong Kong to bid for the right to host the 2009 EAG, we assumed that there would be bids for the host broadcasting rights¹ and that the income so derived would be in the region of \$25 million. Subsequently, after observing the experience gained of the 2005 EAG held in Macau, we adjusted the estimated income from the sale of broadcasting rights downwards to \$12 million when seeking FC's funding approval in January 2006. However, the experience of the Hong Kong leg of the 2008 Beijing Olympic Torch Relay revealed that none of the local electronic media organisations had the required capacity to take up the role of host broadcaster for the Torch Relay. To overcome this problem, a consortium involving all the local electronic media organisations was formed to share the filming work at cost and, in return, they were granted free broadcasting rights for the Torch Relay.

Taking into account the arrangements for the Olympic Torch Relay and in view of the large number of EAG venues (20 venues and some public roads) and competition events (around 700) to be covered, the EAG Company and the local electronic media organisations agreed in early 2009 that a consortium should be formed to arrange for the filming and broadcasting of the 2009 EAG. The seven local electronic media organisations agreed among themselves the division of production work for the EAG ceremonies and competitions, having regard to manpower and equipment availability. Under the consortium model, the local electronic media organisations were required to provide production crews, equipment and coverage of the EAG ceremonies and competition events **at cost** and, in return, were granted free broadcasting rights. As for overseas broadcasters, the EAG Company engaged an acquisition agent through open tender to handle the sales and distribution of the broadcasting rights. After deducting the commission paid to the agent, the Company received \$1.2 million from the sale of broadcasting rights to 16 overseas

¹ The host broadcaster is responsible for the shooting and production of Games footage and feeding the television signals to a broadcasting centre for distribution to local and overseas rights holders.

broadcasters.

As one of the consortium partners for the 2009 EAG, TVB produced the opening ceremony and the athletics events and charged the EAG Company **at cost**. The cost covered the provision of equipment and manpower for broadcasting and transmitting the signals to the EAG international broadcasting centre for use by all local broadcasters and overseas right holders. The EAG Company is contractually bound not to disclose the actual cost charged by individual consortium partners without the consent of the party concerned. The EAG Company consulted RTHK on the costs charged by all consortium partners. Given the scale and complexity of the opening ceremony, the duration of the athletics events and the need to use highly sophisticated equipment to capture the athletes, RTHK considered that the costs quoted by TVB were fair and reasonable.

Negotiations with the local electronic media organisations were carried out by the EAG Company, not LCSD. As all local electronic media organisations carried out the production work at cost, it would be difficult to quantify the amount of money saved by adopting the consortium model. As regards the sale of TV rights to overseas broadcasters, we consider that the EAG Company's interest was appropriately served with the engagement of the acquisition agent to negotiate the terms and conditions on its behalf.

(d) Reasons for variations in income and expenditure

As stated in the FC submission in 2006, the Government's objective was to ensure that the EAG Company would use its best endeavour to economise on its expenditure, live within the sums appropriated by the FC and generate revenues for organising the EAG. We consider that these objectives have been achieved in that the Company had lived within the funding approved by FC and attained a balanced final account with a surplus to be returned to the Government.

For a major international sports event such as the EAG the preparation of which straddled some six years, it is not unusual to find variations between the estimated and actual income and expenditure in respect of individual items. Further to the response provided to the Audit Commission earlier, we enclose at **Annex C**

a more detailed analysis of the main reasons for the variations between the estimated and actual income and expenditure for the items highlighted in the Audit report.

(e) Financial review of the equestrian events

We have not conducted any financial review on the organisation of the Equestrian Events of the 2008 Beijing Olympics and Paralympics as it was funded by the Beijing Organising Committee for the Games of the XXIX Olympiad (BOCOG). The HKSAR Government did not provide the Equestrian Company with funding for organising the Equestrian Events in Hong Kong. As the Equestrian Company was a registered company, its audited financial statements were filed with the Company Registry for public inspection and can be obtained from the Registry on request.

(f) Breakdown of “other income”

The \$26.1 million “other income” comprises -

(i) EAG Fund Raising Concerts	\$19.75 million
(ii) Income from pro-shop, banner promotion and video wall promotion services, EAG stamps and magazine, bank interest and sundry items	\$ 6.33 million
Total	\$26.08 million

(g) Source of funding of the legacy project

A table showing the sequence of events for the arrangements for funding the EAG legacy projects is at **Annex D**. The documents requested in paragraph (g) (i) to (iv) of your letter are at Appendices (I) - (VI) of Annex D. Taking into account the general principles set out in the advice obtained from the Financial Services and Treasury Bureau (FSTB) in June 2010, the EAG Company identified a sponsorship of \$10 million for the purpose of the legacy projects. With the approval of the Secretary for Home Affairs (SHA) and its Board of Directors, the Company implemented the legacy projects with the \$10 million sponsorship, which was from a sponsor other than Sponsor A.

We wish to point out that the last batch of government funding disbursed to the Company was received in November 2009. The \$10 million sponsorship used to fund the legacy projects was received in January 2010 and its purpose was in support of the EAG generally but not designated for any specific EAG activities or expenditure items. Given its timing, this \$10 million sponsorship (from a sponsor other than Sponsor A) could easily be differentiated from the government funding disbursed to the Company. Funding the legacy projects with this sponsorship met the principles set out in FSTB's memo dated 1 June 2010 and has suitably taken into account the wishes of the Sponsor to support the EAG and sports development. The Company therefore sought its Board's approval in mid-June 2010 accordingly.

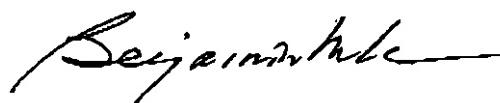
(h) EAG Company's financial statements from 1 April to 30 June 2010

The audited financial statements of the EAG Company for its last three months of operation from 1 April to 30 June 2010, which have been submitted to the Inland Revenue Department for tax assessment, are at **Annex E**.

(i) Admission tickets issued to District Councils

Of the 44 974 admission tickets issued to all guests for the 22 sports events, about 18% of the tickets were issued to District Councils.

Yours sincerely,



(Benjamin Mok)
for Secretary for Home Affairs

c.c. Director of Leisure and Cultural Services (Fax No.: 2606 1824)
Secretary for Financial Services and the Treasury (Fax No.: 2596 0729)
Director of Audit (Fax No.: 2583 9063)

***Note by Clerk, PAC:** *Annex E not attached.*

**Breakdown of 80 Time-limited Civil Service Posts
(2006-07 to 2010-11)**

Time	Rank	Monthly Salary (at Mid-point Salary)	Number
April 2006 to August 2010 (4 years 5 months)	Chief Executive Officer	\$83,060	1
	Senior Executive Officer	\$60,890	1
	Assistant Clerical Officer	\$15,875	1
	Personal Secretary II	\$15,875	1
Sub-total (I):			4
Late 2007 to March 2010 (2 years 4 months)	Chief Leisure Services Manager	\$83,060	1
	Senior Leisure Services Manager	\$69,105	1
	Leisure Services Manager	\$55,640	3
	Assistant Leisure Services Manager I	\$40,515	2
Sub-total (II):			7
Late 2008 to March 2010 (1 year 4 months)	Chief Leisure Services Manager	\$83,060	1
	Senior Leisure Services Manager	\$69,105	2
	Assistant Leisure Services Manager I	\$40,515	6
Sub-total (III):			9
June to December 2009 (7 months)	Executive Officer I	\$44,400	15
Sub-total (IV):			15
Mid Oct to Dec 2009 (2 months)	Executive Officer I	\$44,400	2
	Executive Officer II	\$29,400	43
Sub-total (V):			45
Total ((I) – (V)):			80

**Detailed Accounting Arrangements of the EAG Company
for Recognition of Sponsorship and Government Grant**

Under the Company's accounting policy, **sponsorships and other revenues** were first recognised as “deferred income” during the year of receipt, and then as “revenue” in the period in which direct and related expenses were incurred. In the financial year 2009-10, a significant balance of the “deferred income” from sponsorships was actually “accounts receivable”. It was therefore appropriate to carry forward the balance after recognising part of the “deferred income” from sponsorships, and then recognise the remaining balance after the “accounts receivable” had been received by the Company. Under Hong Kong Accounting Standard 20 – Accounting for Government Grants and Disclosure of Government Assistance, a **government grant** would not be recognised as revenue until there was reasonable assurance that the entity (i.e., the Company) would comply with the conditions attached to the grant (i.e., the Tripartite Agreement), and that the grant would be received accordingly. Under the terms of the Tripartite Agreement, the Government had discretion over the frequency and amount of each disbursement of the grant to meet the cash flow requirements of the Company. The primary role and objective of the Company in delivering the EAG was met in the 2009-10 financial year (i.e., the EAG were held in December 2009) and the full amount of

government grant (\$113,350,000) was received by the Company. In addition, a significant portion of the “deferred income” from sponsorships was “accounts receivable”. Therefore, it was appropriate to recognise the government grant in the same financial year in one go, in compliance with the relevant Accounting Standard and the Company’s accounting policy.

The accounting treatments for the recognition of sponsorships and government grant reflected progress in delivering the EAG as well as the Company’s accounting policy and the actual funding situation. All deferred income from both government grant and sponsorships was recognised upon the conclusion of EAG.

Annex C

Analysis of variations between estimated and actual income and expenditure items of the Hong Kong 2009 East Asian Games

Item	Estimate (January 2006) (In Million)	Actual (June 2010) (In Million)	Reasons for variation
Income			
(a) Community / Commercial Sponsorship	50	131.4	The increase was attributable to keen support from the community and to the fact that the original estimate was highly conservative.
(b) Ticket Sales	28	11	The decrease was due to the setting of a lower ticket price at the time of sale (\$50 on average) than the original estimate (\$100 on average). The adjustment was made in response to FC Members' views that the ticket price should be low to encourage people to watch the EAG. Also, the sales proceed of student tickets taken up by a sponsor were credited as sponsorship income.

Item	Estimate (January 2006) (In Million)	Actual (June 2010) (In Million)	Reasons for variation
(c) Licensing and Merchandising	15	0.8	The decrease was mainly due to the lack of experience in assessing the market response to merchandise of games of a similar scale.
(d) Television Rights	12	1.2	Please refer to the detailed explanation set out in item (c) of the covering letter.
(e) Other Income	4	26.1	The increase was mainly due to an excellent response to the two EAG fund-raising concerts.
Expenditure			
(f) Opening and Closing Ceremonies	35	63.4	The increase was due to the improved standard and quality of the opening ceremony. More expenditure was incurred to erect LED screens to enable the public to watch the opening ceremony and fireworks on-site. These enhancements were made possible by sponsorships obtained for the purpose.

Item	Estimate (January 2006) (In Million)	Actual (June 2010) (In Million)	Reasons for variation
(g) Accommodation and Catering	15	25.5	The increase was due to the redirection of accommodation and catering costs of VIPs from “VIP hospitality” to this item. Also, hotels and catering prices were higher in 2009 than estimated in late 2005.
(h) Volunteers	8	12.3	The increase was due to an increase from 3 000 to 6 000 in the number of volunteers recruited.
(i) Transportation	4	10.5	The increase was due mainly to the redirection of the transportation cost for VIPs from “VIP hospitality” to this item.
(j) VIP Hospitality	8.5	2.7	The decrease was due to the redirection of the transportation, accommodation and catering costs of VIPs from this item to other items (see (g) and (i) above).

**Legacy Projects of the 2009 East Asian Games
Sequence of Relevant Events**

Date	Event
Early Nov 2009	Sponsor A donated \$10M to EAG Company to enhance the Opening Ceremony
Nov 2009	LCSD allocated the last tranche of Government funding to the EAG Company
Nov 2009	Sponsor B indicated that it would donate \$10M to the EAG Company (no specific expenditure item mentioned)
2-13 Dec 2009	2009 EAG
22 Jan 2010	EAG Company received \$10M from Sponsor B and banked it on 27 Jan 2010 (copies of the cheque, the Company's receipt voucher and bank statement are at <i>Appendix I</i>)
Early May 2010	LCSD consulted HAB on the use of the unallocated balance (\$20M) on the proposed legacy projects. HAB agreed to the proposed legacy projects. (Extract of the relevant content of the submission to HAB is at <i>Appendix II</i>)
17 May 2010	LCSD wrote to FSTB seeking its views on the proposed legacy projects (Extract of the relevant memo is at <i>Appendix III</i>)
25 May 2010	At FSTB's request, LCSD provided supplementary information (Extract of the relevant correspondence is at <i>Appendix IV</i>)
1 June 2010	FSTB replied to LCSD setting out its views on the use of the unallocated balance for the proposed legacy projects (Extract of FSTB's reply is at <i>Appendix V</i>)
Early June 2010	In the light of FSTB's reply, LCSD sought HAB's views on the proposal to use \$10M of the unallocated balance on the two legacy projects. HAB agreed to the proposal set out in a draft board paper.

Date	Event
Mid June 2010	LCSD informed the EAG Company that the draft board paper could issue to its Board of Directors. The Board paper was subsequently approved by directors (A copy of the board paper is at <i>Appendix VI</i>).

***Note by Clerk, PAC:** *Appendices I and II not attached.*

**Extracts from LCSD's memo dated 17 May 2010
seeking FSTB's view on the Proposed Legacy Project**

Proposed EAG Legacy Project

The 5th EAG, the first large-scale international multi-sport games ever held in Hong Kong, was concluded successfully last December. While the EAG Company is finalising its accounts for winding up in end June 2010, it has been giving thoughts to how Hong Kong's hosting of the 5th EAG could be commemorated in a meaningful and long-lasting way. The Company has now proposed to launch an EAG legacy project so as to continue the spirit of the EAG and to mark the success of Hong Kong in hosting this special event.

Having explored different options and taking into account practices adopted by other cities hosting major multi-sport events, the Company proposes that the EAG legacy project should comprise both tangible and intangible elements :

- (a) installing commemorative plaques at 19 EAG-related venues owned by LCSD, including 16 competition venues and three other venues where the 100-day countdown, flag raising and opening ceremonies were held, so as to create a tangible legacy for EAG; and
- (b) setting up an EAG fund or scholarship for the long-term benefits of Hong Kong athletes and the creation of an intangible but long-lasting EAG legacy.

On (a) above, the Company would arrange for the design and production for the commemorative plaques which will display the relevant EAG mascots and events, as well as the dates on which the events were held at that particular venue. The installation would be completed before late June 2010 when the Company is scheduled to wind up.

On (b) above, since the resounding success of the EAG was due in a large measure to our athletes' outstanding achievements in the Games (110 medals including 26 gold, 31 silver and 53 bronze), setting up an EAG fund or scholarship that would support the long-term development of our athletes directly would be a fitting recognition of their contributions and a meaningful way to create an EAG legacy. However, as the Company is scheduled for winding up next month, instead of setting up a new fund that requires separate fund administration, the Company proposes to donate its funds to existing athletes' programmes so as to minimize the administrative work and expenditure involved. In this connection, we have identified two possible funds, namely the Hong Kong Athletes Career and Education Programme (HKACEP) and the Hong Kong Athlete Fund (HKAF), both with the objective of helping Hong Kong's serving and retired athletes to pursue excellence in their sports and to support their career and educational development, for the purpose of the donation. The HKACEP is operated by the Sports Federation and Olympic Committee of Hong Kong (SF&OC). Through supporting top athletes' career and education development, the Programme aims to nurture well respected world class sports talents to be the role models of youth and to honour their sports achievements and dedication to Hong Kong's sports success. The HKAF, operated by the Hong Kong Sports Institute Limited (HKSI), aims to provide grants for educational and other academic training to individual athletes to enable them to pursue excellence in their chosen sports and provide them with the opportunity to develop alternative careers upon retirement from sports. Information on the HKACEP and the HKAF is at Annex A and B respectively.

The donation to both funds will be a welcomed addition to the on-going efforts to support Hong Kong athletes' career and education development, which is a major area of concern of the sports community. To highlight and commemorate the outstanding achievements of Hong Kong's athletes in the 5th EAG, it is proposed that an EAG scholarship or sub-fund should be set up under the HKACEP and/or the HKAF or both so as to benefit the EAG medalists/athletes (including participants in future EAGs) directly. We agree that this would be a meaningful way to create a more long lasting legacy for the 5th EAG hosted by Hong Kong

and would be warmly welcomed by the sports sector. The Company's legal advisor has confirmed that donating the Company's money to funds that will benefit athletes falls within the Memorandum of Articles and Association of the Company which states that the Company may "subscribe or guarantee money for charitable/religious or educational objects, and to promote, contribute to or assist financially or otherwise any fund for any charitable purposes".

Funding Position of the Company

The EAG Company is scheduled to wind up by the end of June 2010 and it has been finalizing its account. As can be seen from the latest draft income and expenditure statement of the Company as at 31 March 2010 at Annex C, it is anticipated that there will be an unallocated balance of funding of about \$20M if all the money receivable is duly received. The unallocated balance is a combined result of the concerted efforts of all parties concerned to contain costs, the lower expenditure arising from a lower-than-expected turnout of VIPs and participants at the Games and the better than expected ticket sales and sponsorship. With this balance, the Company would have sufficient funding to pursue the proposed legacy projects.

Funding Approval by Finance Committee

The Finance Committee (FC) of the Legislative Council approved a funding of \$123M vide FCai FCR(2005-06)40 for the purpose of EAG, among which \$113.35M has been allocated to the EAG Company. The Company has also succeeded in securing over \$120 million sponsorship from various sectors of the community. We have examined the proposed EAG legacy projects having regard to the provisions set out in the FCai (Annex D). We note that while the FCai has made no reference specifically to the EAG Company pursuing legacy projects or donating money to funds which will benefit athletes, the preamble of the FCai states that the funding approved by FC is "to provide financial support for the organisation and implementation of the 2009 EAG". As the purpose of the proposed EAG legacy projects is to commemorate the successful hosting of the 5th EAG in Hong Kong and given that it is customary for the hosts of other large-scale multi-sport

games to pursue some kind of legacy projects to continue the spirit of the games in the city, we consider that the proposed legacy project constitutes a logical and justifiable extension of the implementation of the 5th EAG. The proposed donation to funds that support long-term sports and athletes development is also in line with one of the objectives of hosting of the 5th EAG as set out in paragraph 4(c) of the FCai, i.e. “to foster the development of our sports standard and culture”. As such, we believe that the use of the Company’s funding to fund the proposed legacy project including the setting up of an EAG sub-fund/scholarship under existing athletes programmes falls within the funding ambit approved by FC.

We note that paragraph 18 of the FCai states that “surplus funding from the event, if any, up to the amount of government subsidy provided and hiring charges waived, shall be returned to the Government”. Since the proposed legacy project would form part of the overall implementation of the 5th EAG, we believe that the use of the \$20M by the EAG Company for the purpose of pursuing such project could be legitimately charged as an expenditure item under the Company’s account. As such, the said amount would be deducted from the Company’s account as an expenditure item before calculating the net surplus, if any, to be returned to the Government upon the winding up of the Company and after settlement of all its debts and liabilities.

Grateful to know if you would have any views on the proposal set out in paragraph 3 above. As the EAG Company has to wind up in end June and allowing time to its Board of Director’s formal endorsement of the proposals, your reply by 24 May 2010 would be much appreciated. Please let me know if you need further information.

***Note by Clerk, PAC:** *Annexes not attached.*

Appendix IV

Extracts from LCSD's supplementary information provided to FSTB on 25 May 2010

We spoke last week. As requested, I attach a summary of the disbursement of government funding to the EAG Company and other parties from 2006-07 onwards.



Summary of financial position for the organisation of 2009 EAG(2009-10),final with schedules.xls

You may wish to note that the last batch of government funding, amounting to \$14M (or 11% of the \$123M government funding) was disbursed to the Company in October/November 2009. That said, the allocation had actually been committed and the expenditure approved by the EAG Planning Committee back in May 2009 for the organization of the Games. The deferred disbursement from Government was mainly due to the time taken to assess the sum to be disbursed to EMSD which was responsible for the provision of technical support services for the Games.

On the other hand, the Company has received some substantial last-minute donations, including a \$10M donation secured in November 2009 for enhancing the EAG opening ceremony and other publicity efforts. There were also sponsorships in kind received in November 2009, including \$2M sponsorship for sports equipment and \$0.5M for courier services for delivering doping samples to Beijing. It can be argued that quite a large proportion of the unallocated funding (about 65%) was due to the efforts made by the Company in securing last-minute sponsorship.

Government funds allocated for the organization of 2009 EAG

Year	2006-07	2007-08	2008-09	2009-10	Total
	\$	\$	\$	\$	\$
EAG Company					
May/June	2,000,000.00	7,800,000.00	19,650,000.00	40,000,000.00	69,450,000.00
Oct /Nov	2,550,000.00	8,088,895.85	19,059,405.76	14,201,698.39	43,900,000.00
RTHK	0.00	0.00	650,000.00	0.00	650,000.00
EAGA Secretariat (SF&OC)	1,750,000.00	1,461,104.15	1,690,594.24	2,098,301.61	7,000,000.00
LCSD*	0.00	0.00	0.00	2,000,000.00	2,000,000.00
Total :	6,300,000.00	17,350,000.00	41,050,000.00	58,300,000.00	123,000,000.00

* Retained by LCSD for payment of venue operating and transport related expenses, with actual expenditure of \$1,931,931.00 and remaining of \$68,069.

Extracts from FSTB's reply dated 1 June 2010

You sought our views on a proposal to fund a legacy project in commemoration of the hosting of the 5th EAG in Hong Kong by using an unallocated balance of \$20M left in the EAG Company's account. In making this proposal, you regard the proposed legacy project as a logical and justifiable extension of the implementation of the EAG, and one which fulfils the objective of fostering the development of Hong Kong's sports standard and culture as mentioned in the relevant Finance Committee (FC) paper. On these bases, you consider the legacy project falls within the ambit of FC's funding approval and can be funded by the \$20M in question.

FC approved the creation of a commitment of \$123M to provide financial support for "the organization and implementation" of the EAG. We have considered carefully the components of the proposed legacy project, viz. installation of commemorative plaques at various venues and provision of extra funds to further support Hong Kong athletes. In our view, these are post-implementation initiatives instead of part of the EAG implementation. We also find it difficult to fit the proposed legacy project into any of the expenditure items for organising and implementing the EAG (para. 12 of the FC paper and its Enclosure 5).

Paragraph 18 of the FC paper requires surplus funding from the event be returned to the Government. We understand that the EAG Company does not maintain separate accounts for Government allocation and sponsorship. They all form a general pool of resources. Any unallocated balance of that pool of resources then falls within the meaning of surplus funding. This being the case, it would be inappropriate to fund the legacy project by using the unallocated balance left in the EAG Company's account.

That said, if all (or part) of the unallocated balance of \$20M can be clearly attributed to community/commercial sponsorship received by the EAG Company, depending on the sponsorship terms, one could argue that the Government may not necessarily have the first claim on the balance (or that part of it).

We note from the supplementary information provided in your email that the EAG Company secured some \$10M donation in cash in November 2009. At that juncture, expenditure related to the implementation of EAG had largely been met with the EAG Company's general pool of resources. As a result, that \$10M cash donation was virtually not trapped and has now become a significant proportion of the unallocated balance. It appears that with reference to the timing of securing the donation, the EAG Company is able to differentiate the \$10M cash donation from the general pool of resources already in existence for meeting EAG related expenditure. On this basis, we consider it reasonable not to regard the sum as part of the surplus funding for return to the Government for the time being, until all legitimate ways of expending it have been exhausted. In fact, if the donation is expended legitimately, it is no longer part of the unallocated balance. You mentioned in the email that the \$10M cash donation was for enhancing the EAG opening ceremony and other publicity efforts. It is for the EAG Company to consider whether that donation can be used legitimately to fund the proposed legacy project, seeking clarification from the donor as necessary.

As regards the sponsorships in kind totalling \$2.5M received in November 2009, we understand they were consumed during the EAG events, i.e. entered into the general pool of resources for meeting EAG related expenditure. And since they have been spent, they do not account for any part of the unallocated balance.

In short, other than the \$10M cash donation which can be differentiated from the EAG Company's general pool of resources, the remainder of the unallocated balance should be regarded as surplus funding from the event, and should be returned to the Government.

We have further considered the option of apportioning the unallocated balance based on the ratio of Government allocation to commercial sponsorship. We have concluded that the term "surplus funding" in the FC paper does not provide any basis for such apportioning. Therefore, we do not recommend pursuing this option.

We fully appreciated that the proposed legacy project is a worthwhile initiative on its own. In case the unallocated balance will need to be returned to the General Revenue according to the FC paper, you may wish to consider other alternative funding options, such as drawing on the sports portion of the Arts and Sport Development Fund.

**Extracts from the EAG Company's Board Paper
seeking approval for the Proposed EAG Legacy Project**

Purpose

This paper seeks Members' approval for the 2009 East Asian Games (Hong Kong) Limited (the Company) to pursue an EAG legacy project in commemoration of the successful staging of the 5th EAG in Hong Kong.

Background

The EAG was concluded successfully last December and the Company is finalising its account with a view to starting the legal winding up procedure in end June 2010. Based on the latest draft income and expenditure statement of the Company up to 31 March 2010 at Annex A, it is anticipated that there will be an unallocated balance of funding of about HK\$21M if all the money receivable is duly received. The unallocated balance is a combined result of the concerted efforts of the Company and relevant parties to contain costs and expenditure for the Games and the better than expected ticket sales and sponsorship received.

The Company's main sources of funding are Government allocation (\$113.35M) and cash sponsorship (\$131.33M). Since the Company does not maintain separate accounts for receiving Government allocation and sponsorship respectively, all the money received has been deposited into the same account. Clause 16 of the Tripartite Agreement for the EAG signed among the Government, the Company and the Sports Federation and Olympic Committee of Hong Kong, China (SF&OC) states that "any surplus funding for the event, if any, up to the amount of government subsidy provided and hiring charges waived, shall be returned to the Government."

To clarify whether the entire amount of the unallocated

balance needs to be returned to the government, the Company has consulted the relevant government authorities on the proper way of disposing the balance. Among the HK\$21M unallocated balance, it should be noted that a sum of HK\$10M cash donation was secured by the Company only in late November 2009. Given that the unallocated balance amounts to HK\$21M, it can be argued that the Company had already exhausted the Government allocation by November 2009 and that HK\$10M of the unallocated balance came from cash sponsorship received by the Company afterwards. Taking into account the timing of securing the donation and the above line of argument, the relevant government authorities agree to segregate the HK\$10M sponsorship from the Company's income and to allow the Company to dispose of the sum at its own discretion. For the remainder of the unallocated balance (HK\$11M), the relevant authorities consider that it should be regarded as surplus funding from EAG and be returned to the Government according to Clause 16 of the Tripartite Agreement. In other words, out of the HK\$21M unallocated balance, the Company may keep HK\$10M for such uses as deemed appropriate by its Board and return the remaining HK\$11M and any other surplus upon the dissolution of the Company to the Government in accordance with the Tripartite Agreement.

Proposed EAG Legacy Project

To continue the spirit of the EAG and to mark the success of Hong Kong in hosting the first ever large-scale international multi-sports games, we propose to make use of the HK\$10M to pursue a legacy project comprising both intangible and tangible elements as set out in the ensuing paragraphs.

(a) The tangible element – installation of commemorative plaques at EAG venues

Commemorative plaques will be installed in 21 EAG-related venues (including 19 LCSD venues and two other venues) to leave a tangible legacy for the 5th EAG. The list of venues to be installed with commemorative plaques and the design of the plaque are at Annexes B and C respectively. The budget for this project is HK\$200,000 which has been approved by the Chief Executive Officer of the Company under

delegated authority and in accordance with the Company's procurement guidelines. The project will be completed by end of June.

(b) The intangible element – donation to athletes funds

As a meaningful and long-lasting way to commemorate Hong Kong hosting the 5th EAG, we propose to donate the remaining HK\$9.8M at the Company's disposal (after deducting HK\$200,000 for (a) above) to existing funds/programmes with the objective of supporting the long-term development of Hong Kong's athletes, thereby creating an intangible EAG legacy. Since the resounding success of the EAG was due in a large measure to our athletes' outstanding achievements in the Games, the setting up of an EAG fund or scholarship that will support the long term development of our athletes directly will be a fitting recognition of their contributions and a meaningful way to commemorate the 5th EAG. However, as the Company is about to wind up, instead of setting up a new fund that requires separate fund administration, donating the sum to existing athletes' fund will minimise administrative work and expenditure while benefiting the athletes. In this connection, we have identified two possible funds, namely the Hong Kong Athletes Career and Education Programme (HKACEP) and the Hong Kong Athletes Fund (HKAF), both with the objective of helping Hong Kong's serving and retired athletes to pursue excellence in their sports and to support their career and educational development, for the purpose of the donation.

The HKACEP is operated by the SF&OC and overseen by the Home Affairs Bureau. Through supporting top athletes' career and education development, the Programme aims to nurture well respected world class sports talents to be the role models of youth and to honour their sports achievements and dedication to Hong Kong's sports success. The HKAF, operated by the Hong Kong Sports Institute Limited, is a sub-fund of the Sir David Trench Fund which is monitored by the Sir David Trench Fund Committee. The HKAF aims to provide grants for educational and other academic training to individual athletes to enable them to pursue excellence in their chosen sports and provide them with the opportunity to develop alternative careers upon retirement from sports. Information on the HKACEP and the HKAF is at Annexes D and E respectively.

It is proposed to divide the HK\$9.8M surplus equally and donate HK\$4.9M to each of the two athlete funds. To commemorate the outstanding achievements of Hong Kong athletes in the 5th EAG, we will request, as part of the terms and conditions for the donation, that an EAG scholarship or sub-fund should be set up under the HKACEP and the HKAF. The use of the EAG donation will be generally in line with the existing objectives, terms and conditions of the respective funds, with the inclusion of the following specific requirements to provide an inherent link to EAG –

- (a) the donation should be put into an EAG sub-fund/scholarship to be set up under the respective funds;
- (b) on top of the eligibility criteria set by the respective funds, the beneficiaries of the EAG donation should be Hong Kong athletes, serving or retired, who have participated in major games, including the Olympic Games, Asian Games, East Asian Games and priority should be given to EAG athletes; and
- (c) the existing arrangements adopted by the respective funds should generally be applicable to the vetting and approval of applications for the EAG fund/scholarship.

We envisage that the proposed donation to the two athletes funds and the creation of an intangible legacy for the 5th EAG will be welcomed by the sports community. The Company's legal advisor has also confirmed that donating the Company's money to funds that will benefit athletes falls within the Memorandum of Articles and Association of the Company. The relevant government authorities are also agreeable to the Company's proposed ways of disposing its HK\$10M unallocated balance.

Way Forward

Subject to Members' endorsement, we will arrange to donate the sum to HKACEP and HKAF with the inclusion of the specific

requirements stated in paragraph 9 above and to complete the installation of commemorative plaques before the winding up of the Company.

Advice Sought

Members are invited to approve the proposed EAG legacy project.

***Note by Clerk, PAC:** *Annexes not attached.*

**Tripartite Agreement
for The 2009 East Asian Games**

THIS AGREEMENT made this ~~TENTH~~ day of ~~JUNE~~ 2006
AMONGST

The Government of the Hong Kong Special Administrative Region acting through the Secretary for Home Affairs whose principal office is situate at 8th Floor, West Wing, Central Government Offices, 11 Ice House Street, Central, Hong Kong ("Government") of the one part

AND

The Sports Federation and Olympic Committee of Hong Kong, China, a registered society whose registered address is situate at 2/F, Olympic House, 1 Stadium Path, So Kong Po, Causeway Bay, Hong Kong ("SF&OC") of the second part

AND

The 2009 East Asian Games (Hong Kong) Limited, a registered company limited by guarantee whose current registered address is situate at the Leisure and Cultural Services Headquarters, 1 Pai Tau Street, Sha Tin, Hong Kong ("Company") of the third part

WHEREAS

1. With the efforts made by the SF&OC and support from the Government, Hong Kong has been granted by the East Asian Games Association the hosting right of the 2009 East Asian Games ("the Games").
2. The Company has been incorporated for the purpose of organization, implementation and delivery of the Games.

3. The Government, the SF&OC and the Company have agreed to work closely for the organization, implementation and delivery of the Games.
4. To enhance cooperation and to enable smooth and timely organization, implementation and successful delivery of the Games, the Government, the SF&OC and the Company have agreed to enter into this Agreement to set out the detailed arrangements and the roles and responsibilities of the parties hereto in the organization, implementation and delivery of the Games.

THE PARTIES HERETO set out their agreement as follows:-

Objectives

1. The Games will be the first ever multi-sports international games to be hosted in Hong Kong. The successful organization, implementation and delivery of the Games will, *inter alia*, enhance Hong Kong's sports exchange with the East Asian member places, foster the development of local sporting culture, and educate the community on the value of sports, and consolidate Hong Kong's position as a major sports events capital in the region.

Institutional Set-up

2. An East Asian Games Planning Committee ("Planning Committee"), with wide representation from the community, is appointed by the Government to plan for and steer the organization, implementation and delivery of the Games. The Planning Committee is the forum for

the Government, the sports sector and the community to work together for the successful delivery of the Games. The Secretary for Home Affairs and the President of the SF & OC are the President and the Chairman of the Planning Committee respectively.

3. The Company has been set up as the executive arm of the Planning Committee to prepare for, organize, manage, implement and deliver the Games. The Chairman of the Planning Committee is the Chairman of the Board of Directors of the Company.

Roles and Responsibilities of the Government

4. The roles and responsibilities of the Government in the organization, implementation and delivery of the Games are -

- (a) To seek the appropriation of funds from the Legislative Council to support the organization, implementation and delivery of the Games and to ensure that the sums appropriated are spent in a cost effective manner within the scope approved.
- (b) To provide sports venues and facilities to standards considered appropriate by the Government and in consultation with the local National Sports Associations for the organization, implementation and delivery of the Games.
- (c) To facilitate protocol, logistics and coordination as appropriate for the organization, implementation and delivery of the Games.
- (d) To appoint the Planning Committee and to ensure that issues over the planning, organization, implementation and delivery of the Games are properly deliberated.

- (e) To be represented on the Board of Directors of the Company to oversee the work of the Company.
- (f) To cooperate and work together with the SF & OC and the Company to promote and publicize the Games and to seek community participation and involvement in the Games.

Roles and Responsibilities of the SF&OC

5. The roles and responsibilities of the SF & OC in the organization, implementation and delivery of the Games are -

- (a) The SF & OC is formed, established and operates under the rules and regulations of the Olympic Charter and the Olympic Council of Asia.
- (b) As the National Olympic Committee ("NOC") of Hong Kong, the SF & OC is the applicant and right holder for organizing the Games. The Company shall carry out the actual and day-to-day organizing work of the Games.
- (c) The President of the SF & OC is the chairman of the Planning Committee and the SF & OC is represented on the Planning Committee to advise on the planning, organization, implementation and delivery of the Games.
- (d) The President of the SF & OC is the chairman of the Company and the SF & OC is represented on the Board of Directors of the Company to oversee the work of the Company.
- (e) The SF & OC shall liaise with the East Asian Games Association and the member National Olympic Committees for the organization, implementation and delivery of the Games.
- (f) The SF & OC shall liaise with member National Olympic

Committees, and relevant International Federations and Asian Federations and local National Sports Associations to draw up sports items selected for competition at the Games, and shall submit the sports items selected to the Planning Committee for consideration and then to the East Asian Games Association for endorsement. The SF & OC, in consultation with the local National Sports Associations, shall advise the East Asian Games Association, the Planning Committee and the Company on the competition requirements, competition methods, competition management of the sport items selected.

- (g) As the host NOC of the Games, the SF & OC shall serve as the Secretariat of the East Asian Games Association for the Games, and shall organize, manage and chair the East Asian Games Association Council meetings and other related sessions.
- (h) The SF & OC shall procure the approval of the East Asian Games Association for the various usages of the emblem, anthem and mascot of the Games by the Company for the Games.
- (i) The SF & OC shall cooperate and work together with the Government and the Company to promote and publicize the Games and to seek community participation and involvement in the Games.
- (j) The SF & OC shall conduct in a proper and lawful manner all its business and activities in relation to the organization, implementation and delivery of the Games.

Roles and Responsibilities of the Company

6. The roles and responsibilities of the Company in the implementation and delivery of the Games are -

- (a) To be responsible for the organization, implementation and delivery of the Games.
- (b) To receive funds from the Government for the organization, implementation and delivery of the Games and to be fully accountable to the Government and the Legislative Council on the disbursement of such.
- (c) To use its best endeavours to generate revenue for the Games through the seeking of community and commercial sponsorship, selling of television rights, Games event admission ticket sale, licensing and merchandising, the provision of accommodation arrangement for the Games, etc. provided that no sponsorship from tobacco and alcohol shall be accepted. The Company shall use all revenue generated solely for the organization, implementation and delivery of the Games.
- (d) To submit quarterly progress report to the Government and the Planning Committee on the organization, implementation and delivery of the Games.
- (e) To conduct in a proper and lawful manner all its business and activities in relation to the organization, implementation and delivery of the Games.

Financial arrangements

Budget

7. The estimated operating budget for the organization, implementation and delivery of the Games is HK\$240 Million and its details are set out in Annex I.

8. With the approval of the Legislative Council, the Government will

provide up to a maximum of HK\$123 Million for the organization, implementation and delivery of the Games. The Company shall use its best endeavours to economize on its expenditure and to live within the sums appropriated.

9. The Government may provide interest-free cash advance to support the cash flow requirement of the Company. The Company agrees to repay the Government on demand the amount of cash advance as shall be determined by the Government.

10. Other income for the organization, implementation and delivery of the Games shall come from community and commercial sponsorship, selling of television rights, Games event admission ticket sale, licensing and merchandising, provision of accommodation arrangement for the Games and other sources as shall be approved by the Government. An estimate of such income is set out in Annex II.

11. The hiring charges for venues provided by the Government for the organization, implementation and delivery of the Games as well as office accommodation at Government venues for the Company will be waived.

Cost control

12. The Government will arrange for the disbursement of the approved funding and cash advance if any to the Company to enable it to meet the reasonable expenditure for the organization, implementation and delivery of the Games. The Government has discretion over the frequency and quantum of each disbursement. The Government also has the right to impose requirements on the Company as are necessary or in line with

relevant stipulations in Government financial circulars to ensure the proper disbursement of public funds.

13. The Company shall keep proper records and accounts for the Games and the Government will have unfettered access to these. The Company shall be alert to the need for transparency and ensure that all decisions made are fully justified and publicly explicable.

14. The Company shall adopt proper internal control to ensure that its funds are used in a cost-effective and accountable manner and in line with the scope authorised by the Legislative Council.

15. More specifically, the Company shall –

- (a) seek the endorsement of the Government on a “planned project budget” as soon as possible upon receipt of funding approval from the Legislative Council;
- (b) devise an internal cost control mechanism to the satisfaction of the Government to track and specify requirements for authorising cost or other variations to the “planned project budget”, all within the funding ambit set by the Legislative Council; and
- (c) prepare periodic budget updates for the scrutiny or approval as appropriate of the Government.

16. The Company shall submit annual audited financial statements to the Government and the Planning Committee within six months after the end of a financial year, and final audited financial statements to the

Government and the Planning Committee within six months of the conclusion of the Games. Within six months of the conclusion of the Games or any sooner termination of this Agreement, surplus funding from the Games, if any, up to the total amount of Government subsidy provided and hiring charges waived, shall be returned to the Government.

Mode of Work

17. The meetings of the Planning Committee and the meetings of the Board of Directors of the Company are the regular forums for the Government and the SF & OC hereto to consider and deliberate on matters relating to the organization, implementation and delivery of the Games. The parties hereto can convene as and when necessary other meetings or initiate any other form of co-operative activities for the organization, implementation and delivery of the Games.

Modification

18. This Agreement may be modified at any time by mutual consent of all the parties hereto.

Commencement and Termination

19. This Agreement shall come into effect on the date of signing by the parties hereto and shall continue to be in force until the conclusion of the Games in 2009 or the winding up of the Company or any sooner termination of this Agreement as agreed by the parties hereto, whichever is the earlier.

Jurisdiction

20. This Agreement shall be construed in accordance with and governed by the laws of the Hong Kong Special Administrative Region and the parties hereto irrevocably agree to submit themselves to the exclusive jurisdiction of the courts of the Hong Kong Special Administrative Region.

Notice

21. All notices required to be served under this Agreement shall be served to the respective addresses of the parties hereto stated in the preamble of this Agreement.

IN WITNESS whereof this Agreement has been executed by the parties hereunder on the date first above written.

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D. H. Lawrence

A simple line drawing of a person standing on a curved surface, looking up at a vertical dashed line. The person is depicted with a few strokes, showing a head, torso, and legs. The surface they are standing on is a simple arc. The vertical dashed line is composed of several short, vertical dashes.

**Expenditure Estimate for the Organization, Implementation and
Delivery of the 2009 East Asian Games**

<u>Expenditure items</u>	<u>Estimate (HK\$M)</u>
(a) Staff	60
(b) Administration	15
(c) Information technology facilities and equipment	12
(d) Broadcasting cost	20
(e) Accommodation and catering	15
(f) Competition event cost	26
(g) VIP hospitalities	8.5
(h) Transportation	4
(i) Publicity	10
(j) Opening and Closing ceremonies	35
(k) Security	10
(l) Volunteers	8
(m) EAG Association meetings	5
(n) Contingency	11.5
Total	240

**Revenue Estimate for the Organization, Implementation and
Delivery of the 2009 East Asian Games**

<u>Revenue items</u>	<u>Estimate (HK\$M)</u>
(a) Community/Commercial sponsorship	50
(b) Television rights	12
(c) Ticket sales	28
(d) Licensing and merchandising	15
(e) Charged accommodation	8
(f) Other income	4
Total:	117

存案 Filed

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MEMORANDUM
AND
ARTICLES OF ASSOCIATION
OF
2009 EAST ASIAN GAMES (HONG KONG) LIMITED
2009 東亞運動會(香港)有限公司

Incorporated the day of

WONG LAM LEUNG & KWOK C.P.A. LIMITED
Room 1101, 11th Floor,
China Insurance Group Building,
141 Des Voeux Road Central,
Hong Kong.

Ref: T449\S\PWM&A-FINAL

22/02/2005

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Sh. Form :

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\$170.00

TOTAL(CHG)

\$170.00



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THE COMPANIES ORDINANCE (CHAPTER 32)

Company Limited by Guarantee
And Not Having a Share Capital

MEMORANDUM OF ASSOCIATION
OF
2009 EAST ASIAN GAMES (HONG KONG) LIMITED
2009 東亞運動會(香港)有限公司

1. The name of the Company is "2009 EAST ASIAN GAMES (HONG KONG) LIMITED 2009 東亞運動會(香港)有限公司" (hereinafter called "the Company").
2. The registered office of the Company will be situated in Hong Kong.
3. The objects for which the Company is established are:
 - (1) To carry out the organization of the Fifth East Asian Games (hereinafter called "the Games") to be held in Hong Kong in 2009, enabling the Games to educate the community on the value of sports thereby improving the health of the public, and to enhance Hong Kong's status as a sports event capital.
 - (2) To co-operate with and to involve different sectors of the community, *including but not limited to sports, education, business and tourism* sectors, in the implementation of the Games; and to take all necessary steps in the organisation of the Games to promote, maintain and advance the interest of the public of Hong Kong in sports and to educate the public so as to enhance social cohesion at the community level.
 - (3) To work closely with the Sports Federation and Olympic Committee of Hong Kong, China and national sports associations or other related organizations in the process of the organization of the Games in order to help educate the community on the value of sports and to help Hong Kong athletes to enhance their level in sports.

- (4) To promote the exchange of information, experience, international understanding and goodwill so as to educate the sports community in the organization of major international sports events; and to educate and encourage the community in the participation and involvement in the various stages of the preparation work for the Games.
- (5) For the furtherance of the above objects, to organize, produce, manage, conduct and implement at any sports venues and related facilities, or such other places, such work plans, programmes and activities relating to the organization of the Games.
- (6) In connection with all or any objects of the Company to train volunteers to help implementation of the Games.
- (7) In connection with all or any objects of the Company to employ persons or companies any where to carry out tasks of various nature in connection with the work and activities of the Company.
- (8) To acquire, hold and transact any intellectual property rights for pursuing its objects.
- (9) To purchase, hire or otherwise acquire any instrument, whether photographic, recording and other apparatus, and equipment in connection with the work and activities of the Company.
- (10) For the purpose of the Games to make available the facilities and services at the Company for use by the community, at a fee or free of charge.
- (11)
 - (a) For the purposes of the Games to borrow and raise money in such manner as the Company shall think fit and to secure the repayment of any money borrowed, raised, or owing, whether by mortgage, charge, lien or other security, upon the whole or any part of the *Company's property or assets (whether present or future)*, and also by a similar mortgage, charge, lien or security to secure and guarantee the performance by the Company of any obligation or liability undertaken by or which may become binding on the Company.
 - (b) To take and accept any donations and gifts of money or money's worth or in kind, whether outright or upon trusts connected with any of the objects of the Company or similar objects and promotion of health through sports in Hong Kong.
 - (c) For the purposes of the Games to invest and deal with the moneys of the Company not immediately required in such manner as may from time to time be determined and to hold, sell or otherwise deal with any investments made.

- (12) (a) For the purposes of the Games to purchase, lease, exchange, hire or otherwise acquire lands and premises for the management, operation, storage and activities and performances of the Company.
- (b) For the purposes of the Games, to alter, demolish, reconstruct, or refurnish any premises whether or not for the time being owned, leased or occupied by the Company.
- (c) To construct, maintain, alter, demolish and reconstruct any premises, works or property whether or not belonging to the Company as are necessary and convenient for the purposes and objects of the Company and for the purposes of the Games.
- (13) To subscribe or guarantee money for charitable/ religious or educational objects, and to promote, contribute to or assist financially or otherwise any fund for any charitable purposes.
- (14) For the purposes of the Games to grant, sell, assign, manage, lease, develop, exchange, mortgage, transfer, dispose of, turn to account or otherwise deal with all or any part of the property and rights of the Company.
- (15) To carry on all or any of the foregoing activities whether in Hong Kong or elsewhere.
- (16) To do all such other lawful things as are incidental or conducive to the attainment of the above objects.

Provided always that:-

- (i) In case the Company shall take or hold any property which may be subject to any trusts, the Company shall have further power to deal with or invest the same in such manner as allowed by law, having regard to the terms and conditions of such trusts.
- (ii) The objects of the Company shall not extend to the regulation of relations between workers and employers or organizations of workers and organizations of employers.
- (iii) The powers set forth in the Seventh Schedule to the Companies Ordinance (Chapter 32) are hereby excluded.

4.
 - (1) The income and property of the Company, howsoever derived, shall be applied solely towards the promotion of the objects of the Company as set out in this Memorandum of Association without prejudice to the proviso under Clause 3 above.
 - (2) Subject to paragraphs (4) and (5) below, no portion of the income and property of the Company shall be paid or transferred directly or indirectly, by way of dividend, bonus, or otherwise howsoever, to the members of the Company.
 - (3) No Director shall be appointed to any salaried office of the Company, or any office of the Company paid by fees and no remuneration or other benefit in money or money's worth (except as provided in paragraph (5) below) shall be given by the Company to any Director.
 - (4) Nothing herein shall prevent the payment, in good faith, by the Company of reasonable and proper remuneration to any officer or servant of the Company, or to any member of the Company not being a Director in return for any services actually rendered to the Company.
 - (5) Nothing herein shall prevent the payment, in good faith and upon presentation of invoices, demands or other due documentation, by the Company to any Director of proven out-of-pocket expenses.
5. The liability of the Members is limited.
6. Every member of the Company undertakes to contribute to the assets of the Company in the event of its being wound up while he is a member, or within one year after he ceases to be a member, for payment of the debts and liabilities of the Company contracted before he ceases to be a member, and of the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves, such amount as may be required not exceeding one hundred dollars in Hong Kong currency.
7. If upon the winding up or dissolution of the Company there remains, after the satisfaction of all its debts and liabilities, any property whatsoever, the same shall not be paid to or distributed among the members of the Company; but shall be given or transferred to some other institution or institutions having objects similar to the objects of the Company, and which shall have the same or greater degree of restriction as is imposed on the Company under or by virtue of Clause 4 above in relation to the distribution of its or their income and property amongst its or their members, such institution or institutions to be determined by the members of the Company at or before the time of dissolution and in default thereof by a Judge of the High Court of the Hong Kong Special Administrative Region, and, if this provision cannot be effected, then to some charitable objects.

We, the several persons whose names, addresses and descriptions are hereto subscribed, are desirous of being formed into a company in pursuance of this Memorandum of Association.

Names, Addresses and Descriptions of Subscribers

Signatures

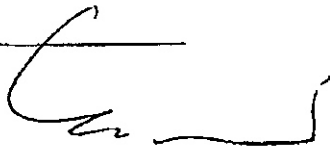
1. Name : SIU Yu Bun, Alan (蕭如彬)



Address : 16th Floor,
Leisure and Cultural Services Headquarters,
1-3 Pai Tau Street, Sha Tin, New Territories.

Occupation : Civil Servant

2. Name : CHAN Yeuk Oi, Olivia (陳若譚)

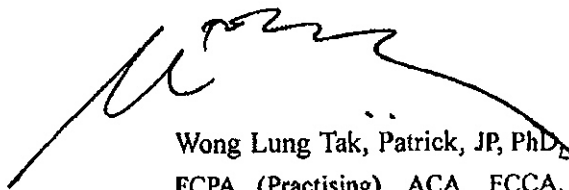


Address : 15th Floor,
Leisure and Cultural Services Headquarters,
1-3 Pai Tau Street, Sha Tin, New Territories.

Occupation : Civil Servant

Dated this 21st day of February 2005.

Witness to the above signatures:-



Wong Lung Tak, Patrick, JP, PhD,
FCPA (Practising), ACA, FCCA,
FAIA, MSCA, FCIS, FCS, ATiHK,
FHKIoD
Chartered Secretary
Room 1101, 11/F.,
China Insurance Group Bldg.,
141 Des Voeux Road Central,
Hong Kong.

THE COMPANIES ORDINANCE (CHAPTER 32)

Company Limited by Guarantee
And Not Having a Share Capital

ARTICLES OF ASSOCIATION
OF
2009 EAST ASIAN GAMES (HONG KONG) LIMITED
2009 東亞運動會(香港)有限公司

Interpretation

1. In these Articles unless the context otherwise requires –

- “Board” means the Board of Directors of the Company constituted under Article 28;
- “Chairman” means the chairman of the Board of Directors and shall be nominated by the Secretary for Home Affairs;
- “Director” means a member of the Board of Directors;
- “general meeting” means an annual general meeting or an extraordinary general meeting;
- “Government” means the Government of the Hong Kong Special Administrative Region;
- “Member” means a member of the Company as determined by Article 3(3) and shall be nominated by the Secretary for Home Affairs;
- “month” means calendar month;
- “Ordinance” means the Companies Ordinance, Chapter 32;
- “organization” means any firm, society, association, institution, body corporate or unincorporate, or group of firms, societies, associations, institutions, body corporates or unincorporates;
- “registered office” means the registered office of the Company;
- “seal” means the Common Seal of the Company;
- “Secretary” means the Secretary elected by the Board of Directors under Article 36;
- “Secretary for Home Affairs” means the Secretary for Home Affairs of the Government;
- “Company” means the 2009 EAST ASIAN GAMES (HONG KONG) LIMITED 2009 東亞運動會(香港)有限公司;
- “Vice Chairman” means the vice chairman of the Board of Directors and shall be nominated by the Secretary for Home Affairs;
- “year” means calendar year.

Any word importing the singular number only shall include the plural number and vice versa.

Words importing the masculine gender only shall include the feminine gender and organizations as herein defined.

These Articles shall be construed with reference to the provisions of the Ordinance and terms used in these Articles shall be taken as having the same respective meanings as they have when used in the Ordinance.

Expressions in writing shall, unless the contrary intention appears, be construed as including references to printing, lithography, photography, and other modes of representing or reproducing words in a visible form.

Purpose

2. The Company is established for the purposes and objects expressed in the Memorandum of Association.

Membership

3. (1) (i) For the purposes of registration with the Companies Registry, the number of Members shall not be more than twenty (20). With approval from the Secretary for Home Affairs, the Board may from time to time register an increase of number of Members.
(ii) The subscribers to the Memorandum of Association of the Company will automatically become the first Members of the Company.
- (2) (i) Subject to Article 3(3), all members shall be voting members and shall be nominated by the Secretary for Home Affairs for appointment by the Board and shall hold membership for not more than 2 years and shall thereafter be eligible for reappointment to the Company for further periods. No members shall be appointed or reappointed without recommendation from the Secretary for Home Affairs.
(ii) Any member of the Company may, on giving not less than one month's notice in writing to the Secretary for Home Affairs and the Board, resign from the Company.
(iii) If the Secretary for Home Affairs advises and agrees, the Board shall terminate the appointment to the Company any member during the membership of such member:-

- (a) on being requested in writing so to do by a majority of three-quarters of the members present at any meeting resolving such course;
 - (b) in the case of incapacity of such member;
 - (c) in the case of absence from Hong Kong for more than 12 months of such member.
- (3) A Member may be either an individual natural person or an organization. An Organization Member shall be represented by an individual who will perform its membership functions.

Patron and Honorary Membership

- 4. The Secretary for Home Affairs shall have power to invite on behalf of the Board a person of distinction to serve as a Patron of the Company. The Board shall make such appointment upon advice of the Secretary for Home Affairs. A person as a Patron shall not be a voting member of the Company and shall have no voting rights.
- 5. The Secretary for Home Affairs may recommend distinguished persons to be Honorary Members of the Company provided that there shall not be at any time more than twenty Honorary Members. The Board shall make such appointment of Honorary Members upon advice of the Secretary for Home Affairs. An Honorary Member is not a voting member and shall have no voting rights. The Board of Directors may also make recommendations and seek the advice of the Secretary for Home Affairs, through the annual general meeting, on the persons they consider fit for appointment as Honorary Members.
- 6. The notice containing the names of the Patron and Honorary Members appointed by the Board on the advice and recommendation of the Secretary for Home Affairs shall be posted in a conspicuous place in the Company. No person shall be appointed as Patron and Honorary Members without recommendation of the Secretary for Home Affairs.

Rights of Members

- 7. The rights and privileges of a Member shall be personal to himself or to the organization as the case may be; they shall not be transferable by his or its own act and shall cease upon his death or its dissolution as the case may be or upon his or its ceasing from any cause to be a Member under the provision of these Articles.
- 8. Any person who shall for any cause cease to be a Member shall nevertheless remain liable for and shall pay to the Company all moneys which, at the time of his ceasing to be a Member, may be owed by him to the Company.
- 9. Members shall, as soon as practicable, communicate any change of address to the Company.

10. Without prejudice to the application of Articles 12, 13 and 14 below, every Member on joining the Company impliedly undertakes to comply with these Articles, and any refusal or neglect to do so, or any performance of conduct unworthy of a Member, shall render his or her membership liable to termination by a resolution passed at a general meeting under Article 3(2)(iii)(a), provided that at least three weeks before such meeting he or she shall have had written notice of the meeting and of the allegations made against him or her and of the intended resolution, and that he or she shall at such meeting and before the passing of such resolution have had an opportunity of giving orally or in writing any explanation or defence he or she may think fit. A Member terminated under this rule shall forthwith forfeit all his membership rights.

Cessation of Membership

11. The Board shall have the power to terminate the appointment of any members and to re-appoint any new members in substitution thereof. Such power shall only be exercised after consultation with the Secretary for Home Affairs and the Secretary for Home Affairs is in agreement thereto.

General Meetings

12. The Company shall in each year hold an annual general meeting in addition to any other meetings in that year, and shall specify the meeting as such in the notices calling it; and not more than 15 months shall elapse between the date of one annual general meeting of the Company and that of the next. Provided that so long as the Company holds its first annual general meeting within 18 months of its incorporation, it needs not hold it in the year of its incorporation or in the following year. The annual general meeting shall be held at such time and place as the Chairman of the Board shall appoint.
13. All general meetings other than the annual general meetings shall be called extraordinary general meetings.
14. *The Chairman of the Board may, whenever it thinks fit, convene an extraordinary general meeting.*

Notice and Conduct of General Meetings

15. An annual general meeting and a meeting called for the passing of a special resolution shall be called by 21 days' notice in writing at the least, and a meeting of the Company other than an annual general meeting or a meeting for the passing of a special resolution shall be called by 14 days' notice in writing at the least. The notice shall be exclusive of the day on which it is served or deemed to be served and of the day for which it is given, and shall specify the place, the day and the hour of meeting and, in the case of special business, the general nature of that business, and such information shall be given in the manner hereinafter mentioned or in such other manner as may be prescribed by the Company in general meeting

to such persons as are under these Articles entitled to receive such notices from the Company. Provided that a meeting of the Company shall, notwithstanding that it is called by a shorter notice than that specified in this Article, be deemed to have been duly called if it is so agreed :-

- (a) in the case of a meeting called as the annual general meeting, by all the Members entitled to attend and vote at the meeting; and
 - (b) in the case of any other meeting, by a majority in the number of Members having a right to attend and vote at the meeting, being a majority together representing not less than ninety five percent of the total voting rights of all the Members entitled to attend and vote at that meeting.
16. The accidental omission to give notice of a meeting to, or the non-receipt of notice of a meeting by, any Member entitled thereto shall not invalidate the proceedings at any meeting.
17. All business that is transacted at both extraordinary general meeting and annual general meeting shall be deemed special save and except the business for considering the accounts, balance sheets, and the reports of the Board and auditors and the appointment of auditors and fixing of their remuneration at annual general meeting.
18. Subject to Article 25, no business shall be transacted at any general meeting unless a quorum of Members who are entitled to vote thereat is present at the time when the meeting proceeds to business, and such quorum shall consist of at least two in number or one-third of the total number of Members for the time being, whichever is the greater, of the Members present in person.
19. If within half an hour from the time appointed for the meeting a quorum is not present, the meeting, if convened upon the requisition of members, shall be dissolved: *in any other case it shall stand adjourned to the same day in the next week, at the same time and place, or to such other days and at such other time and place as the Board may determine, and if at the adjourned meeting a quorum is not present within half an hour from the time appointed for the meeting the members present shall be a quorum.*
20. The Chairman of the Board shall preside as chairman at every general meeting of the Company. If at any meeting the Chairman shall not be present within fifteen minutes after the time appointed for holding the meeting, or if he shall have previously notified the Company of his intention of not being present, a Vice Chairman shall preside the meeting, or if failing him, the Directors present shall elect one of their number to preside, or if no such Director be present or willing to take the chair the meeting shall stand adjourned.

21. At any general meeting, a resolution put to the vote at the meeting shall be decided on a show of hands and a declaration by the chairman that a resolution has been carried (unanimously or by a particular majority) or lost, and followed by an entry to that effect in the book containing the minutes of the proceedings of the Company shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour of or against that resolution.
22. In the case of an equality of votes the chairman shall be entitled to a second or casting vote.
23. Every Member with voting rights shall have one vote.

Proxies

24. The instrument appointing a proxy shall be in writing under the hand of the appointer or of his attorney duly authorized in writing, or, if the appointer is a corporation, either under the seal or under the hand of an officer or attorney so authorized. A proxy may not be a Member of the Company.
25. The instrument appointing a proxy shall (except to the extent to which the proxy is specially directed to vote for or against any proposal) include the power to act generally at the meeting for the person giving the proxy.
26. Every instrument of proxy shall, as nearly as circumstances will admit, be in the following form or to the effect following or in such other form as the Board may from time to time determine:-

"I, *being a Member of 2009 EAST ASIAN GAMES (HONG KONG) LIMITED 2009 東亞運動會(香港)有限公司*, hereby appoint
of
or failing him, of
, or failing him, of
as my proxy to vote for me and on my behalf at the Annual (or Extraordinary or adjourned, as the case may be) General Meeting of the Company, to be held on the day of , 20 ,
and at any adjournment thereof.

Signed this day of , 20 .

This form is to be used either in favour of or against the Resolution.

Unless otherwise instructed the proxy will vote as he thinks fit."

27. The instrument appointing a proxy shall be deposited at such place and by such hour as the Company may determine; otherwise the person so named shall not be entitled to vote in respect thereof. No instrument appointing a proxy shall be valid except for the meeting mentioned therein and any adjournment thereof.

Board

28. (1) The Board shall have the overall management of the affairs, administration and business of the Company, and shall be the overall governing body. The initial and each subsequent Board shall consist of not less than two or more than twenty directors. The Directors shall all be nominated by the Secretary for Home Affairs for appointment by the Board to fill a casual vacancy or at the general meeting.

(2) The Board, shall have power at any time, and from time to time to appoint any person as a Director, to fill a casual vacancy or as an addition to the Board upon advice and recommendation of the Secretary for Home Affairs as to the choice of nominees. Any Director so appointed by the Board shall hold office only until the conclusion of the next annual general meeting of the Company and shall then be eligible for reappointment. No Directors shall be appointed or reappointed without recommendation from the Secretary for Home Affairs.
29. All subscribers of the Memorandum of Association shall become Directors of the first Board. Other Directors of the first Board shall be appointed under Articles 28(1) and 28(2).
30. The Directors shall be offered a term of not more than two years and shall be eligible for reappointment to the Board for further such periods if the Secretary for Home Affairs shall agree.
31. The Board, subject to the provisions of the Memorandum of Association and these Articles, shall conduct and regulate the affairs of the Company, which includes appointing persons to sign and operate bank accounts. The Board shall have powers to rent offices for the use of the Company and to appoint such staff, salaried or otherwise, as may be found necessary for the proper conduct of the affairs of the Company, to engage professional assistance and to remunerate all persons employed.
32. Subject to Article 51, a Director shall cease to be appointed to his office if Article 11 applies to his case. The vacancies so arisen will be filled in accordance with Article 28(2).
33. Subject to the provisions of these Articles, the Board shall have power to convene its own meetings and regulate its own proceedings.
34. (1) The Board shall cause minutes to be made in books provided for the purpose of the proceedings at all meetings of the Company and of the Board and to record:-
 - (a) All appointments of officers made by the Board;
 - (b) The names of the Directors present at each meeting of the Board and of any committees of the Board;

- (c) All resolutions passed and decisions made in all meetings of the Company, of the Board and committees of the Board.
- (2) Every Director present at any meeting of the Board or a committee of the Board shall sign his name in a book to be kept for that purpose.

Officers

35. The officers of the Company shall comprise of the following:-

- (1) Chairman;
- (2) Vice Chairman ;
- (3) Secretary;
- (4) Such other officers (having such duties and responsibilities) as the Board may from time to time designate.

The Board shall not appoint a single Director to hold more than one of the following three posts of Chairman, Vice Chairman and Secretary at any one time. ~~The Secretary and such other officers abovementioned may not be Directors.~~

- 36. The Board shall in each year following the conclusion of the annual general meeting seek the recommendation and agreement of the Secretary for Home Affairs to appoint the Chairman, Vice Chairman and Secretary and the other officers for a term of up to two years. All officers of the Company shall continue to serve if re-appointed until their respective successors are duly appointed. No officers shall be appointed or reappointed without recommendation from the Secretary for Home Affairs.
- 37. The Chairman shall preside over meetings of the Board and the Company and shall perform such duties as are customarily attached to this office.
- 38. The Secretary shall keep the record of all the meetings of the Board and of the Members. He shall keep custody of the properties of the Company. In addition, he shall perform the duties customarily incidental to his office or those required by the Board, the Chairman or the Vice Chairman.
- 39. In the absence of or in case of the disability of the Chairman, the Vice Chairman shall serve as acting chairman. In rare situation where the Chairman and Vice Chairman are unavailable to perform their duties, the Directors shall elect one of their number to act as chairman. The Board shall provide for successions and acting designations to cover other contingencies which may arise.

Proceedings of the Board

40. The Board may meet together for the dispatch of business, adjourn and otherwise regulate their meetings and business as they think fit. Meetings of the Board may be convened on the request of the Chairman or Vice Chairman or in writing by any Director stating the objects for which such meetings are to be convened and forwarded to the Secretary.
41. The Chairman or Vice Chairman or in the absence of both, the Directors present shall elect one of their number to act as chairman and to preside at meetings of the Board.
42. The quorum necessary for the transaction of the business of the Board shall comprise at least fifty percent of the total number of Directors and being at least two in number, personally present throughout the meeting concerned.
43. Questions arising at any meeting (except as herein otherwise mentioned) shall be decided by a majority on a show of hands and in case of an equality of votes the Chairman or failing him, the acting chairman of the meeting shall have a second or casting vote.
44. The continuing Directors may act notwithstanding any vacancy in their body but if and so long as their number is reduced below the number fixed by or pursuant to the regulations of the Company as not reaching the necessary quorum for Board meetings, the continuing Directors may be continued to act for the purpose of seeking advice and recommendation from the Secretary for Home Affairs as to nomination of directors and to make appropriate appointment to fill causal vacancies.
45. The Board may, if it thinks fit, transact any of its business by the circulation of papers and a resolution in writing signed by all the Directors for the time being *shall be as effective for all purposes as a resolution of the Board passed at a meeting duly convened, held and constituted.* An electronic, telephone or other facsimile documentary transmission of, or confirmation of, such resolution in writing and sent by a Director shall be deemed to be his signature to such resolution in writing for the purposes of this Article and such resolution in writing may in such circumstances consist of more than one document.
46. Except as provided in Article 44 hereof a meeting of the Directors for the time being at which a quorum is present shall be competent to exercise all the authorities, powers and discretions by or under the regulations of the Company for the time being vested in the Board generally, provided that all Directors have been given reasonable prior notice of such meeting.
47. (1) The Board may, from time to time, appoint such committees as it considers necessary for the efficient discharge of its functions, and may delegate to any such committees any of its powers and duties.

- (2) Any committee so appointed shall, in the exercise of the powers so delegated, conform to any regulations that may be imposed on it by the Board.
- (3) Any committee so appointed shall have at least one Director.
- 48. All acts done by the Board or by a committee appointed as aforesaid or by any person acting as a Director or committee shall, notwithstanding that it be afterwards discovered that there was some defect in the appointment of any such Director or committee or person acting as aforesaid, or that they or any of them were disqualified, be as valid as if every such person had been duly appointed or was qualified to be a Director.
- 49. Any vacancy occurring in the Board by reason of death, resignation or other disability or incapacity may be filled by the Board as advised and recommended by the Secretary for Home Affairs but the person so chosen shall be subject to the same conditions as to eligibility and tenure of office as his predecessor.
- 50. The Board shall be responsible for raising funds from all legitimate sources in order to support the activities of the Company and shall endeavour to oversee and supervise the organization of all fund raising activities of the Company.

Disqualification of Directors

- 51. The office of a Director shall be vacated if the appointment is revoked by the Board as advised by the Secretary for Home Affairs. The Board must act according to the advice of the Secretary for Home Affairs without delay.
- 52. The Officers of the Company as defined in Article 35 shall be vacated if:
 - (1) he becomes bankrupt or makes a composition or scheme of arrangement with his creditors;
 - (2) he is found lunatic or becomes of unsound mind or is subjected to other mental incapacity;
 - (3) he resigns his office by notice in writing to the Company; or
 - (4) the Board otherwise basing on the advice and recommendation of the Secretary for Home Affairs determines that there is a good cause for his removal.
- 53. Subject to the provisions of the Memorandum of Association and these Articles, a Director or officer shall disclose the nature of his interest in any matter concerning the Company and shall not attend or vote in any meetings of the Company or engage in any discussion whereby matters that he is interested in would be considered or discussed.

Accounts

54. The Board shall cause proper books of account to be kept with respect to all sums of money received and expended by the Company covering all the incomes and expenditures, assets and liabilities and all sales and purchases of goods by the Company. Proper books shall not be deemed to be kept if such books of account are not kept in the required way as are able to give a true and fair view of the Company's affairs or its transactions conducted.
55. The books of account shall be kept at the registered office of the Company, or, subject to the Ordinance, at such other place or places as the Board thinks fit, and shall always be open to the inspection of the Directors and the Secretary for Home Affairs.
56. The Board shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations the accounts and books of the Company or any of them shall be open to the inspection of Members not being Directors and no Member (not being a Director) shall have the right of inspecting any account or book or document of the Company except as conferred by law or by the Company in general meeting or otherwise authorized by the Board.
57. The Board shall from time to time in accordance with the provisions of the Ordinance cause to be prepared and to be laid before the Company in general meeting such income and expenditure accounts, balance sheets and reports as are referred to in the Ordinance.
58. A copy of every balance sheet (including every document required by law to be annexed thereto) which is to be laid before the Company in general meeting together with a copy of the Auditor's Report shall, not less than twenty one days before the date of the meeting; be sent to all persons entitled to receive notice of general meeting of the Company.
59. The Secretary shall have the power to receive all moneys coming into the Company and the receipt issued by him shall be the official acknowledgement of such payment. The Board shall have absolute discretion to appoint such staff members as it may decide to receive and give receipt for all moneys coming into the Company and to pay the same into the bank. The Board may from time to time select the appropriate bank for depositing its money.
60. All cheques of the Company shall be signed by such persons as are designated by the Board by resolution.

Audit

61. A firm of certified public accountants shall be appointed to the office of auditors and their duties regulated in accordance with the provisions of the Ordinance.

Seal

62. (1) The Board may from time to time make regulations as to the custody and use of the seal of the Company. The seal shall be kept at the registered office or at such other place as the Board shall from time to time determine, and all documents requiring the seal to be affixed thereto shall be signed by the Chairman and countersigned by one of the 2 Vice Chairmen or by the Secretary or such other Director as may from time to time designated by the Board.
- (2) The Company may exercise all the powers conferred by Section 35 of the Ordinance and such powers shall be in the hands of the Board.

Notices

63. A notice may be served by the Company upon any Member either personally or by sending it through the post in a prepaid letter addressed to such Member at his registered address appearing in the Register of Members.
64. Any notice served by post shall be deemed to have been served on the day following that on which the letter containing the same is put into the post except for notices served outside the territory of Hong Kong Special Administrative Region the service shall be deemed to have been served on the second day following the date of posting, and in proving such service it shall be sufficient to prove that the letter containing the notice was written with the correct address and put into the post office as a prepaid letter.

Winding Up

65. The Company may be wound up at any time by a special resolution passed by at least three quarters of the votes of all the Members on the membership register of the Company at an extraordinary general meeting called for that purpose.
66. *Clause 7 of the Memorandum of Association of the Company relating to the winding up and dissolution of the Company shall have effect as if the provisions thereof were repeated in these Articles.*

Advisory Committees

67. The Board may establish and abolish from time to time in its absolute discretion such advisory and consultative committees and groups as it may determine to be in the interest of the Company.

Pre-incorporation contracts and expenses

68. The Company shall ratify all contracts and reimburse all expenses made by the promoters of the Company before incorporation that are solely and necessarily required to be made for the purposes and objects, the incorporation, and the efficient management of the Company.


Miscellaneous

69. The First Secretary of the Company shall be Wong Lam Leung & Kwok Secretaries Limited who may resign from this office upon giving notice to the Company of such intention and such resignation shall take effect upon the expiration of such notice or its earlier acceptance.

Names, Addresses and Descriptions of Subscribers

Signatures

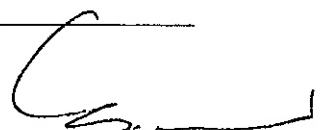
1. Name : SIU Yu Bun, Alan (蕭如彬)



Address : 16th Floor,
Leisure and Cultural Services Headquarters,
1-3 Pai Tau Street, Sha Tin, New Territories.

Occupation : Civil Servant

2. Name : CHAN Yeuk Oi, Olivia (陳若鸞)

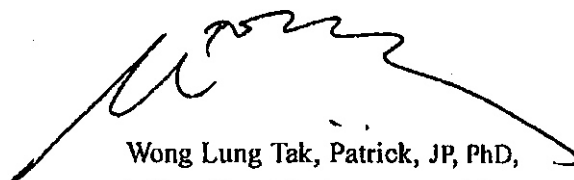


Address : 15th Floor,
Leisure and Cultural Services Headquarters,
1-3 Pai Tau Street, Sha Tin, New Territories.

Occupation : Civil Servant

Dated this 21st day of February 2005.

Witness to the above signatures:-



Wong Lung Tak, Patrick, JP, PhD,
FCPA (Practising), ACA, FCCA,
FAIA, MSCA, FCIS, FCS, ATIIHK,
FHKIoD

Chartered Secretary
Room 1101, 11/F.,
China Insurance Group Bldg.,
141 Des Voeux Road Central,
Hong Kong.

政府總部
民政事務局

香港灣仔
告士打道五號
稅務大樓
四十一樓



GOVERNMENT SECRETARIAT

HOME AFFAIRS BUREAU

41/F, REVENUE TOWER
5 GLOUCESTER ROAD
WAN CHAI
HONG KONG

本署檔號 Our Ref :
來函檔號 Your Ref: CB(4)/PAC/R56

電話 Tel : 2594 5644
傳真 Fax : 2519 7404

6 May 2011

Ms Miranda HON
Clerk to Public Accounts Committee
Legislative Council
8/F, Murray Road Multi-storey Carpark Building
Hong Kong
(Fax No.: 2840 0716)

Dear Ms Hon,

**Public Hearing on
Hong Kong 2009 East Asian Games (Chapter 5)**

At the first public hearing held yesterday, a Member asked if the 2009 East Asian Games (Hong Kong) Limited had received written advice from its legal advisor on its proposal to make donations to the athletes' funds. We would like to confirm that the legal advisor had set out her opinion in an e-mail dated 23 April 2010. With the legal advisor's consent, a copy of her opinion is enclosed for the reference of the Public Accounts Committee.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Benjamin Mok'.

(Benjamin Mok)
for Secretary for Home Affairs

c.c. Director of Leisure and Cultural Services (Fax No.: 2606 1824)
Secretary for Financial Services and the Treasury (Fax No.: 2147 5239)
Director of Audit (Fax No.: 2583 9063)

-----Original Message-----

From: [REDACTED]
Sent: Friday, April 23, 2010 11:11 AM
To: 'esclee@lcsd.gov.hk'
Subject: EAG Company Surplus Funds

Dear Eva,

Questions raised in what way the Company can deal with its surplus funds after conclusion of the Games.

Upon further review of the Memorandum and Articles of Association of the EAG Company, I would like to advise that :

1. Clause 4(1) of the Memorandum provides that the income and property of the Company SHALL BE applied SOLELY towards the promotion of the objects of the Company set out in Clause 3 of the Memorandum.

2. All the objects stated in Clause 3 relate directly to the Games, save the following provisions :

(a) Clause 3(4) : To promote the exchange of information, experience, international understanding and goodwill so as to educate the sports community in the organization of major international sports events;...

(b) Clause 3(3)* : To subscribe or guarantee money for charitable/religious or educational objects, and to promote, contribute to or assist financially or otherwise any fund for any charitable purposes.

Before the winding up of the Company, the Company may therefore apply its property and income to the above objects according. However, since the Company is bound by the Tripartite Agreement to use its funding towards the Games, I doubt whether the Company can use the income and property towards the above objects if they are not related to the Games, unless the Government agrees to its doing so.

3. Further, **upon winding up of the Company**, it may also transfer its property and income to another institution provided that :

(1) All the company's debts and liabilities have been satisfied fully;

(2) the receiving institution has similar object to Company;

(3) the receiving institution has the same or greater degree of restriction as is imposed on the Company under Clause 4 of the Memorandum in relation to the distribution of its income and property amongst its members;

(4) such institutions shall be determined by the Members of the Company.

(Clause 7 of the Memorandum refers)

4. However, the EAG Company is bound by the Tripartite Agreement to use the funding for the Games and to refund the surplus to the Government. Such "surplus" is in a sense a liability of the Company owed to the Government as a creditor. If however, the Government waives or concludes that the Company is not required to pay such "surplus" to the Government, the Company may transfer the surplus in accordance with Clause 7 of the Memorandum.

5. To conclude, the Company is bound to use its income and property solely for the objects of the Company and in accordance with its Memorandum. Such memorandum may be amended by the Members of the Company. The Company is also bound by its obligations towards the Government under the Tripartite Agreement, such obligations however may be released if the Government agrees.

Should you have any questions, please feel free to let me know.

Regards,

A small black rectangular box used to redact a signature.

[Remarks : * As confirmed by the Legal Advisor, this clause should read as Clause 3(13).]

政 府 總 部

民 政 事 務 局

香港灣仔
告士打道五號
稅務大樓
四十一樓



GOVERNMENT SECRETARIAT

HOME AFFAIRS BUREAU

41/F, REVENUE TOWER
5 GLOUCESTER ROAD
WAN CHAI
HONG KONG

本署檔號 Our Ref : SF(2) to HAB/CS/CR 7/7/8 Pt.2
來函檔號 Your Ref: CB4/PAC/R56

電話 Tel : 2594 5644
傳真 Fax : 2519 7404

31 May 2011

Ms Miranda HON
Clerk to Public Accounts Committee
Legislative Council
8/F Murray Road Multi-storey Carpark Building
Hong Kong
(Fax No.: 2840 0716)

Dear Ms Hon,

**The Director of Audit's Report on the
results of value for money audits (Report No. 56)**

Hong Kong 2009 East Asian Games (Chapter 5)

I refer to your letter of 25 May 2011 requesting further information on the source of funding for the legacy project and would like to provide relevant information as follows –

- (a) The \$10 million sponsorship received from Sponsor B on 22 January 2010 was to support the East Asian Games (EAG) generally and was made without reference to any designated use or specific conditions.
- (b) & (c) Sponsor B made two major donations to the EAG Company. The first one, amounting to about \$13 million, was pledged in early 2009 for specific EAG activities. The second one, amounting to \$10 million, was pledged in November 2009 without reference to any designated use. The second donation did not form a part of nor was it in any way related to the first one. The payment of the second donation was eventually received on 22 January 2010. It is not uncommon for sponsors to pledge a donation before an event is held and to make the actual payment afterwards.

- (d) With regard to the correspondence on the legacy project in May and June 2010: in May 2010, the Leisure and Cultural Services Department (LCSD) wrote to the Financial Services and the Treasury Bureau (FSTB) to propose that the EAG Company should be allowed to use its unallocated balance to fund two legacy projects. In response to an oral enquiry from FSTB, LCSD replied via an email that the Company had received some substantial “last-minute” donations, including the \$10 million donation from Sponsor A for enhancing the opening ceremony. This was cited as an example of a substantial “last-minute” donation secured by the Company, in support of LCSD’s point that a large proportion of the unallocated balance was attributable to such donations. LCSD did not give FSTB an exhaustive list of the last-minute donations received by the Company. To our understanding, the reference to Sponsor A in the reply from FSTB to LCSD was made to help illustrate the general principles that: *“if all (or part) of the unallocated balance of \$20 million can be attributed to community/commercial sponsorship received by the EAG Company, depending on the sponsorship terms, one could argue that the Government may not necessarily have the first claim on the balance (or that part of it)”* (paragraph 4 of Appendix V to Annex D of our previous reply to you). We have confirmed the above understanding with FSTB prior to issuing this letter. LCSD and FSTB did not discuss the specific source of the funding that was proposed for implementing the legacy projects.

As regards the position of the EAG Company: the Company initially took the view that the unallocated balance was the result of the combined efforts of all concerned to minimise expenditure and generate income, hence the final \$21.5 million unallocated balance should not be specifically attributed to individual donations. However, on the advice of the Administration, the Company accepted the general principles relating to the use of the unallocated balance and identified a \$10 million donation that met the principles stipulated by the Government relating to the allocation of funding for a legacy project.

When commenting on the relevant parts of the draft Audit report in February 2011, the former Chief Executive Officer (CEO) of the EAG Company was stating the Company’s initial position that the unallocated balance should not be attributed to one single sponsor. He was aware of the advice of the Administration regarding the use

of the unallocated balance on the legacy projects, and had implemented the projects having due regard to the principles concerned.

Our discussion with the Audit Commission on this area of the draft Audit report focused primarily on the rationale for allowing the EAG Company to use part of the unallocated balance on the two legacy projects; and on whether such use was permissible under the Tripartite Agreement. In February 2011, the former CEO of the EAG Company pointed out to the Audit Commission that the donation from Sponsor A had been used to enhance the opening ceremony. Neither LCSD nor the CEO were asked to clarify further the specific source of funding for the legacy projects.

As the Audit Commission's value-for-money study was conducted more than a year after the EAG was held, the EAG Company had ceased operation and no longer had any working staff. It should be appreciated that it was not always possible in the circumstances for the Administration, which was not directly responsible for organising the EAG, to provide detailed facts and figures within a tight timeframe and to trace the reasons behind some of the decisions taken by the Company. In these circumstances, it is possible that comments given by LCSD did not cover in full each and every aspect of the various issues raised by the Audit Commission.

As requested, the full text of the minute submitted by the Director of Leisure and Cultural Services to the Secretary for Home Affairs on 5 May 2010 is attached at **Annex**.

Yours sincerely,



(Benjamin Mok)
for Secretary for Home Affairs

c.c. Director of Leisure and Cultural Services (fax no. 2606 1824)
Secretary for Financial Services and the Treasury (fax no. 2147 5239)
Director of Audit (fax no. 2583 9063)

Full Text of the LCSD's minute submitted to SHA on 5 May 2010

M.1

**SHA
via PSHA
DS(HA)2**

**Disposal of Surplus Fund and Properties from
The Hong Kong 2009 East Asian Games (EAG)**

PROBLEM

The EAG Company will have a surplus of \$20M. We need to consider how to dispose of the surplus in a proper and meaningful manner.

RECOMMENDATION

2. It is recommended that the surplus and properties of the EAG Company be disposed of by:

- (a) providing \$1M for the EAG legacy project at EAG-related venues;
- (b) donating \$19M to the Hong Kong Athletes Career and Education Programme (HKACEP) and/or the Hong Kong Athlete Fund (HKAF) for the long-term benefits of Hong Kong athletes and the creation of a EAG legacy; and
- (c) transferring the properties (office furniture and equipment) to LCSD.

JUSTIFICATION

The Surplus

3. The EAG has concluded successfully last December and the EAG Company (the Company) has been finalising its account. It is anticipated that

there will be a surplus of about HK\$20M if all the money receivable is duly received. The latest draft income and expenditure statement of the Company as at 31 March 2010 is at Annex A. Furthermore, the Company has procured office furniture and equipment (Annex B) which will be left behind upon its winding up.

4. Although the Company had reviewed and revised the budget on a continuous basis before and throughout the Games, a number of factors, which were not fully within the Company's control, have attributed to the higher than expected surplus. These include:

- (a) **Satisfactory ticket sales** – over 70% of the tickets were sold (80% of the education tickets purchased by *[sponsor's name has been deleted]* were included) and this had resulted in \$3M additional income (as compared to the original estimate) for the Company;
- (b) **Last-minute sponsorship** - sponsorship in kind including courier services for doping samples from Hong Kong to Beijing and supplies for sports equipment for various competitions were finalised at a very late stage, thus contributing to savings of around \$3M.
- (c) **Lower turnout of participants** – the actual number of participants (totalling 3,200 athletes, team officials and VIPs) in EAG, which was finalised and available only in late November 2009, was lower than the Company's original estimate (3,900). As a result, the expenditure on catering, accommodation, VIP hospitality, competition events, etc has reduced by around \$9M; and
- (d) **Other cost savings** – the Company had succeeded in negotiating with some of its contractors/service providers to lower the contract prices, notably in transportation and production costs of the opening ceremony, which has resulted in \$4M savings.

5. The relatively large surplus of EAG is a combined result of the concerted efforts of all to contain costs, the smaller number of participants as well as the better than expected ticket sales and sponsorship. While some may comment that the Company had been too prudent in planning its budget and hence resulted in certain inadequacies, we believe that the surplus should be defensible, especially if we are able to put it into good and meaningful use.

(a) Disposal of the Surplus

6. We have considered various ways to dispose of the surplus having regard to the Tripartite Agreement for 2009 EAG signed among the Government, the EAG Company and the Sports Federation and Olympic

Committee of Hong Kong, China (SF&OC), as well as the Memorandum of Articles and Association (MAA) of the Company. The justifications for our recommendations are as follows:

(i) EAG legacy projects

7. To commemorate Hong Kong hosting the 5th EAG, we propose to install commemorative plaques at 19 EAG-related venues owned by LCSD, including 16 competition venues and three other venues, namely the Kowloon Park Piazza, the Olympic Square in Hong Kong Park and the Hong Kong Cultural Centre Piazza where the 100-day countdown cum torch relay, the flag raising ceremony and the opening ceremony was held respectively. The Company is arranging for the design of these commemorative plaques which will display the relevant EAG mascots and events, as well as the dates on which the events were held at that particular venue. This legacy project is estimated to cost about \$1M. We aim to complete the project by late June 2010 so that the payment can be effected before the Company winds up.

(ii) Donation to the Hong Kong Athletes Career and Education Programme and Hong Kong Athletes Fund

8. To further the spirit of the EAG and having regard to Clause 3(13) of the object of the MAA which states that the Company may “*subscribe or guarantee money for charitable/religious or educational objects, and to promote, contribute to or assist financially or otherwise any fund for any charitable purposes*”, we propose that the remaining surplus (around \$19M) should be used to benefit Hong Kong’s athletes directly. In this connection, two possible funds, both with the objective of helping Hong Kong’s serving and retired athletes to pursue excellence in their sports and to support their career and educational development, have been identified for the purpose of the donation. They are the Hong Kong Athletes Career and Education Programme (HKACEP) and the Hong Kong Athletes Fund (HKAF).

9. The HKACEP is operated by the SF&OC. Through supporting top athletes’ career and education development, the Programme aims to nurture well respected world class sports talents to be the role models of youth and to honour their sports achievements and dedication to Hong Kong’s sports success. The HKAF, operated by the Hong Kong Sports Institute Limited (HKSI), aims to provide grants for educational and other academic training to individual athletes to enable them to pursue excellence in their chosen sports and provide them with the opportunity to develop alternative careers upon retirement from sports. Information on the HKACEP and the HKAF is at Annex C and D respectively.

10. The donation of EAG surplus to either the HKACEP or HKAF or both will be a welcomed addition to the on-going efforts to support Hong Kong athletes' career and education development, a major area of concern of the sports community. To highlight the outstanding achievements of Hong Kong's athletes in the 5th EAG, we intend to explore with SF&OC and HKSI the possibility of setting up an EAG scholarship or a sub-fund under HKACEP and/or HKAF so as to benefit the EAG medallists/athletes (including participants in future EAGs) more directly and to create an intangible but long-lasting legacy for the 5th EAG. We believe that this proposal will be welcomed by the sports sector and will most likely be supported by the Company's Board of Directors.

Alternatives considered

(i) Returning the donation to [sponsor's name has been deleted]

11. We have considered the suggestion of returning to *[sponsor's name has been deleted]* its donation of *[amount of sponsorship has been deleted]*. Although the *[amount of sponsorship has been deleted]* had been claimed and banked in by the Company, the *[sponsor's name has been deleted]* advised that there is no technical hurdle barring the return of the donation. However, we are concerned that the arrangement will attract queries or even criticisms from other EAG sponsors, in particular the *[sponsor's name has been deleted]* which is also a major sponsor of the EAG using its charity funds. They may ask for similar treatment so that they could redeploy the funding to other charitable purposes. In view of the read-across implications, we do not recommend this option. We also anticipate that the Company's Board of Directors (among them is *[sponsor's name has been deleted]*) will not support such proposal.

(ii) Returning the surplus to Government

12. According to the Tripartite Agreement for the 2009 EAG at Annex E (Clause 16), surplus fund from EAG, if any, up to the total amount of Government subsidy provided (\$123 million) and hiring charges waived, shall be returned to the Government. However, the meaning of "surplus" is not clearly defined and is subject to interpretation. If the Government subsidy has been used up in accordance with the Company's object as set out in its MAA and expressed as expenditure items in the Company's account, then only the net surplus upon the winding up of the Company and after settlement of all its debts and liabilities should be returned to the Government. As mentioned in paragraph 8 above and as confirmed by the Company's legal advisor, donating the EAG surplus to funds that will benefit athletes falls within Clause 3(13) of the MAA and could be a legitimate expenditure item.

(b) Disposal of office furniture and equipment

13. As regards the Company's office furniture and equipment, we have considered two options, namely, to dispose them through auction or to give them to LCSD. We do not recommend the auction route as the Company has to incur costs for auction and the items auctioned would unlikely attract good value. Instead, we recommend that they be given away to LCSD upon the winding up of the Company. Not only will this save the Company's administrative cost (the expenditure will otherwise be donated to the athlete funds), the office furniture and equipment could also be put to good use by LCSD as it has to relocate its existing offices in the Hong Kong Park to the Company's office at the HK Squash Centre (HKSC) shortly (see paragraph 14).

14. The Company's office in the HKSC was converted from six squash courts. There is at present adequate supply of squash courts all over the territory. Utilization statistics and other relevant information revealed that the closure of the six squash courts in the past few years has not affected adversely the development of the sport. Moreover, about \$5M had been spent on converting the squash courts into office and the estimated cost for reinstatement obtained from ArchSD is in the region of \$5M. To require the Company to reinstate its office into squash courts will mean a \$5M reduction in the donation to the athlete funds. These factors, coupled with LCSD's genuine need for office space to accommodate the expanded Tree Teams and to relocate its HK Park Management Office currently housed in the Rawlinson House (a Grade 1 historic building in HK Park to be taken over by the Commissioner for Heritage), make the reinstatement of the office into squash courts unnecessary and unjustified. We have sought the views of Hong Kong Squash (the National Sports Association) on our intention not to reinstate the EAG office to squash courts. We do not expect strong objection from them as we have allowed them the continual use of 12 squash courts at the Cornwall Street Squash and Table Tennis Centre even after the return of the elite training base to the HKSI Fo Tan campus early this year.

Way Forward

15. Subject to your endorsement of the recommendations set out in paragraph 2 above, we will sound out FSTB informally on the proposed arrangements. Thereafter, we will assist the Company to seek the Board's approval of the recommendations in May 2010 so that the Company can proceed to appoint a liquidator for the winding up in June 2010.

DLCS
5.5.2010

***Note by Clerk, PAC: Annexes not attached.**



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Wanchai, Hong Kong

圖文傳真 Facsimile : 2583 9063

電話 Telephone : 2829 4219

本署檔號 Our Ref.: (30) in UI/LCD/VFM/9

來函檔號 Your Ref.: CB(4)/PAC/R56

30 May 2011
(By fax 2840 0716)

Clerk, Public Accounts Committee,
Legislative Council,
Legislative Council Building,
8 Jackson Road,
Central, Hong Kong

(Attn: Ms Miranda HON)

Dear Ms HON,

**The Director of Audit's Report on
the results of value for money audits (Report No. 56)**

Hong Kong 2009 East Asian Games (Chapter 5)

Thank you for your letter of 25 May 2011 inviting my comments on the new piece of information provided by the Secretary for Home Affairs in paragraph (g) and Annex D of his letter to the Public Accounts Committee of 24 May 2011 (the Letter) and, in particular, whether the information would affect Audit's observations and recommendations regarding the legacy project.

First of all, the new piece of information provided by the Secretary for Home Affairs that the legacy project was funded by a sponsorship of \$10 million received from **Sponsor B** in January 2010 (instead of the sponsorship of \$10 million received from **Sponsor A** in November 2009) does not affect Audit's observations and recommendations regarding the legacy project. Therefore, our views stated in paragraphs 3.19 and 3.26(d)) of the Audit Report are still valid.

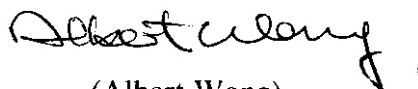
Secondly, we made reference to **Sponsor A's \$10 million sponsorship** in paragraph 3.17 and Appendix C (para. 1(a)) of the Audit Report based on the following information:

- (a) the minute submitted by the Leisure and Cultural Services Department (LCSD) to the Secretary for Home Affairs on 5 May 2010 on the disposal of the surplus fund, specifying the proposed legacy project and an alternative option of returning to Sponsor A his sponsorship of \$10 million in support of the EAG opening ceremony (see para. 11 of the LCSD's minute of 5 May 2010 — full text to be provided by the Secretary for Home Affairs as requested in the Public Accounts Committee's letter of 25 May 2011); and
- (b) the reference to Sponsor A's \$10 million sponsorship secured in November 2009 for enhancing the EAG opening ceremony in the correspondences in May and June 2010 between the LCSD and the Financial Services and the Treasury Bureau (FSTB) (see Appendices IV (para. 3) and V (para. 5) to Annex D of the Letter).

It is also worth pointing out that during the course of the audit review, we could not find records showing that the legacy project was financed by **Sponsor B's sponsorship**, and neither the Home Affairs Bureau nor the LCSD had informed us of this information.

Lastly, I would like to point out that we had indicated our concern about the proposed use of Sponsor A's \$10 million sponsorship to finance the legacy project, given that the sponsorship had already been used to enhance the opening ceremony held in December 2009 (see Note 13 to para. 3.17 of the Audit Report). The former Chief Executive Officer of the 2009 East Asian Games (Hong Kong) Limited (EAG Company) has a similar view (see para. 3.21(c) of the Audit Report). We also share the FSTB's view that any unallocated balance of resource should fall within the meaning of surplus fund as the EAG Company did not maintain separate accounts for the government subsidy and sponsorship (see para. 2(b) of Appendix C of the Audit Report).

Yours sincerely,



(Albert Wong)
for Director of Audit

c.c. Secretary for Home Affairs (fax no. 2840 1902 and 2519 7404)
Secretary for Financial Services and the Treasury (fax no. 2147 5239)
Director of Leisure and Cultural Services (fax no. 2606 1824)



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電話 Telephone : 2829 4219

本署檔號 Our Ref.: (32) in UI/LCD/VFM/9

來函檔號 Your Ref.: CB(4)/PAC/R56

1 June 2011
(By fax 2840 0716)

Clerk, Public Accounts Committee,
Legislative Council,
Legislative Council Building,
8 Jackson Road,
Central, Hong Kong

(Attn: Ms Miranda HON)

Dear Ms HON,

**The Director of Audit's Report on
the results of value for money audits (Report No. 56)**

Hong Kong 2009 East Asian Games (Chapter 5)

I refer to the Secretary for Home Affairs' letter of 31 May 2011 to the Public Accounts Committee (the Letter) copied to me, and would like to make some clarifications.

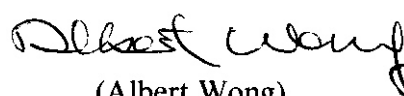
Firstly, regarding the first sentence of the last inset of paragraph (d) of the Letter stating that the value-for-money study was conducted more than a year after the 2009 East Asian Games (EAG) was held, we actually commenced our audit review in early August 2010, about seven months after the completion of the 2009 EAG in mid-December 2009. The audit was conducted shortly after the commencement of the liquidation of the EAG Company in June 2010.

Secondly, the first sentence of paragraph 11 of the Director of Leisure and Cultural Services' minute of 5 May 2010 submitted to the Secretary for Home Affairs (attached to the Letter) should read as follows:

“We have considered the suggestion of returning to *[Sponsor A]* its donation of *[amount of sponsorship has been deleted]* in support of the EAG opening ceremony.”

Paragraph 3(a) of my letter of 30 May 2011 to the Public Accounts Committee is also relevant.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Albert Wong', with a stylized flourish at the end.

(Albert Wong)
for Director of Audit

c.c. Secretary for Home Affairs (fax no. 2840 1902 and 2519 7404)
Secretary for Financial Services and the Treasury (fax no. 2147 5239)
Director of Leisure and Cultural Services (fax no. 2606 1824)

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

DIRECTORS' REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST MARCH, 2010



李 湯 陳 會 計 師 事 務 所

LI, TANG, CHEN & CO.

Certified Public Accountants (Practising)

Hong Kong

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

DIRECTORS' REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST MARCH, 2010

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

DIRECTORS' REPORT

The directors submit to members their report and financial statements for the year ended 31st March, 2010.

PRINCIPAL ACTIVITIES

The company is established for the organization, implementation and delivery of the Fifth East Asian Games (the "Games") which was held in Hong Kong in December 2009, enabling the Games to educate the community on the value of sports thereby improving the health of the public, and to enhance Hong Kong's status as a sports event capital.

ACCOUNTS

The result of the company for the year ended 31st March, 2010 and the state of affairs of the company as at that date are set out in the financial statements on pages 5 to 26.

PROPERTY, PLANT AND EQUIPMENT

Movements of the property, plant and equipment during the year are set out in note (7) on the financial statements.

DIRECTORS

The directors of the company during the year and up to the date of this report were:

Mr. Fok Tsun Ting, Timothy	
Mr. Chan Cho Chak, John	
Mr. Chan Pun, David	
Mr. Chen Nan Lok, Philip	
Mr. Hui Chun Fui, Victor	
Mr. Or Ching Fai, Raymond	
Mr. Pang Chung	
Ms. Chan Yeuk Oi, Olivia	
Mr. McKinley Jonathan Michael David	
Mr. Cheng Kam Wing, Bobby	(appointed on 26.6.2009)
Mrs. Fung Ching Suk Yee	(appointed on 31.8.2009)
Mr. Mok Kwan Yu, Benjamin	(appointed on 17.9.2009)
Mr. Chow Tat Ming, Thomas	(resigned on 10.8.2009)
Ms. Wong Chin Kiu, Janet	(resigned on 28.8.2009)
Mr. Liu Ming Kwong	(resigned on 31.12.2009)

In accordance with articles (28) and (30) of the company's articles of association, all the existing directors shall retire but being eligible for re-appointment to the Board for a term of two years if the Secretary for Home Affairs shall agree.

No contracts of significance to which the company was a party and in which a director of the company had material interest subsisted at the end of the year and at any time during the year.

At no time during the year was the company a party to any arrangement to enable the directors of the company to acquire benefits by means of the acquisition of shares in, or debentures of, the company or any other body corporate.

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

DIRECTORS' REPORT

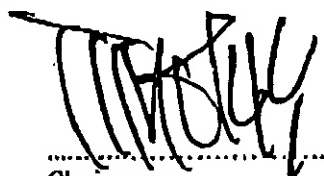
MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the company were entered into or existed during the period.

AUDITORS

The financial statements have been audited by Messrs. Li, Tang, Chen & Co., who retire but, being eligible, offer themselves for re-appointment.

On behalf of the Board

A handwritten signature in black ink, appearing to be 'Li Tang Chen', written over a dotted line.

Chairman

Hong Kong, 24 JUN 2010



**INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF 2010 EAST ASIAN GAMES (HONG KONG) LIMITED**
(Incorporated in Hong Kong with limited liability by guarantee)

We have audited the financial statements of 2009 East Asian Games (Hong Kong) Limited set out on pages 5 to 26, which comprise the balance sheet as at 31st March, 2010, and the statement of comprehensive income, the statement of changes in funds and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

to be cont'd/.....

李 湯 陳 會 計 師 事 務 所
LI, TANG, CHEN & CO.
Certified Public Accountants (Practising)

OPINION

In our opinion, the financial statements give a true and fair view of the state of the company's affairs as at 31st March, 2010 and of its result and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.


Certified Public Accountants (Practising)

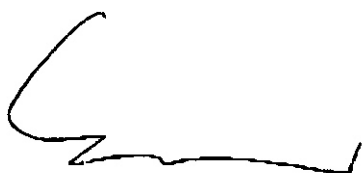
Hong Kong, 24 JUN 2010
RCMC/CKL:pn

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

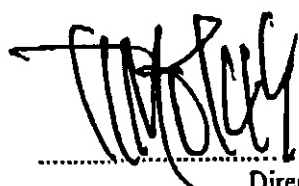
BALANCE SHEET AS AT 31ST MARCH, 2010

	<u>Note</u>	HK\$	<u>2010</u> HK\$	<u>2009</u> HK\$
NON-CURRENT ASSETS				
Property, plant and equipment	7		852,515	802,361
CURRENT ASSETS				
Accounts receivable	8	14,772,624		117,054
Deposits		-		59,000
Prepayments		-		74,858
Cash and bank balances	9	<u>9,256,341</u>		<u>92,362,094</u>
		24,028,965		92,613,006
Deduct:				
CURRENT LIABILITIES				
Accounts payable and accrued expenses		1,066,506		4,473,127
Deferred income	15	<u>23,808,617</u>		<u>88,935,883</u>
		24,875,123		93,409,010
NET CURRENT LIABILITIES			<u>(846,158)</u>	<u>(796,004)</u>
NET ASSETS			<u>6,357</u>	<u>6,357</u>
Representing:				
ACCUMULATED FUND	16		<u>6,357</u>	<u>6,357</u>

The financial statements set out on pages 5 to 26 were approved and authorised for issue by the board of directors on 24 JUN 2010



Director



Director

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31ST MARCH, 2010

	<u>Note</u>	HK\$	<u>2010</u> HK\$	<u>2009</u> HK\$
INCOME				
Government grant - LCSD allocation	10		113,350,000	-
Sponsorship income	11		79,798,200	12,442,472
Licensing and merchandising income			212,891	429,008
Charged accommodation			9,545,538	-
Broadcasting rights			1,242,650	-
Ticket sales			10,993,583	-
Games concert income			-	13,011,505
Other income				
Income from Pro-shop			-	21,505
Banner promotion services income			440,000	480,000
Video wall promotion services income			20,027	55,183
Games magazine income			34,425	8,925
Games stamps income			129,941	1,656
Sundry income			1,641,907	500,300
Bank interest income			283,555	125,659
			<u>2,549,855</u>	<u>692,928</u>
			217,692,717	27,076,213
LESS: EXPENDITURE				
Staff costs	12(a)	23,176,376		15,915,169
Administrative expenses	12(b)	6,372,826		3,704,424
Volunteers	12(c)	6,617,919		4,152,341
Competition events expenses	12(d)	27,941,218		557,775
Publicity and marketing expenses	12(e)	3,853,946		2,598,229
Broadcasting and logistics	12(f)	58,329,145		19,051
Ceremonies and hospitality	12(g)	65,991,000		129,224
Information technology	12(h)	12,364,035		-
Accreditation and security	12(i)	10,593,399		-
Medical services and anti-doping	12(j)	<u>2,452,853</u>		-
			<u>217,692,717</u>	<u>27,076,213</u>
SURPLUS FOR THE YEAR			-	-
INCOME TAX EXPENSE	13		-	-
SURPLUS FOR THE YEAR AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR			<u>-</u>	<u>-</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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STATEMENT OF CHANGES IN FUNDS

FOR THE YEAR ENDED 31ST MARCH, 2010

	<u>Note</u>	<u>Accumulated fund</u>	
		<u>2010</u> <u>HK\$</u>	<u>2009</u> <u>HK\$</u>
Balance brought forward		6,357	6,357
Surplus for the year and total comprehensive income for the year	16	<u>-</u>	<u>-</u>
Balance carried forward		<u>6,357</u>	<u>6,357</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST MARCH, 2010

	<u>Note</u>	<u>2010</u> HK\$	<u>2009</u> HK\$
OPERATING ACTIVITIES			
Surplus for the year		-	-
Adjustments for:			
Deferred income recognised		(193,148,200)	(12,442,472)
Bank interest income		(283,555)	(125,659)
Depreciation on property, plant and equipment		<u>601,559</u>	<u>438,631</u>
Operating deficit before working capital changes		(192,830,196)	(12,129,500)
Decrease in accounts receivable		(597,986)	176,578
Decrease/(increase) in deposits		59,000	(39,084)
Decrease/(increase) in prepayments		74,858	(20,884)
Decrease in security deposit		-	(52,052)
(Decrease)/increase in accounts payable and accrued expenses		<u>(3,406,621)</u>	<u>3,832,929</u>
NET CASH USED IN OPERATING ACTIVITIES		<u>(196,700,945)</u>	<u>(8,232,013)</u>
INVESTING ACTIVITIES			
Acquisition of property, plant and equipment		(651,713)	(484,996)
Interest received		<u>283,555</u>	<u>125,659</u>
NET CASH USED IN INVESTING ACTIVITIES		<u>(368,158)</u>	<u>(359,337)</u>
FINANCING ACTIVITIES			
Government grant obtained	15	54,201,698	38,709,406
Sponsorships received	15	<u>59,761,652</u>	<u>27,882,741</u>
NET CASH GENERATED FROM FINANCING ACTIVITIES		<u>113,963,350</u>	<u>66,592,147</u>
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(83,105,753)	58,000,797
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR		<u>92,362,094</u>	<u>34,361,297</u>
CASH AND CASH EQUIVALENTS AT END OF THE YEAR		<u>9,256,341</u>	<u>92,362,094</u>
ANALYSIS OF THE BALANCES OF CASH AND CASHEQUTVALENTS			
Cash and bank balances		<u>9,256,341</u>	<u>92,362,094</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

1. GENERAL INFORMATION

2009 East Asian Games (Hong Kong) Limited is a company incorporated on 3rd March, 2005 in Hong Kong as a company with limited liability by guarantee without a share capital. Every member of the company undertakes to contribute to the assets of the company, if required in the event of its being wound up, not exceeding HK\$100.

The address of its registered office is 1/F., Hong Kong Park Sports Centre, 29 Cotton Tree Drive, Central, Hong Kong.

The company is established for the organisation, implementation and delivery of the Fifth East Asian Games (the "Games") which was held in Hong Kong in December 2009.

The financial statements are presented in Hong Kong dollars, which is the same as the functional currency of the company.

2. ADOPTION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The following revised standards and amendments which are relevant to the company's financial statements have been adopted in the current year but have no effect on the amounts reported in these financial statements.

- HKAS 1 (revised), Presentation of Financial Statements
- Improvements to HKFRSs (2008)

HKAS 1 (revised) has introduced terminology changes (including revised titles for the financial statements) and changes in the presentation and disclosures of financial statements. The revised standard requires the entity to present, in a statement of changes in equity, all owner changes in equity. All non-owner changes in fund (i.e. comprehensive income) are required to be presented in one statement of comprehensive income or two statements (a separate income statement and a statement of comprehensive income). The company has elected to present one statement of comprehensive income. This change in presentation has no effect on reported profit or loss, total income and expense or net assets for any period presented. Accordingly, the comparative figures have not been restated.

The improvements to HKFRSs (2008) have had no material impact on the company's financial statements.

The company has not early applied the other new standards, amendments and interpretations that have been issued but not yet effective (see note 20).

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

3. BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") (which also include Hong Kong Accounting Standards ("HKASs") and Interpretations), issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the Hong Kong Companies Ordinance. These financial statements have been prepared under the historical cost convention.

The preparation of financial statements in conformity with HKFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The area involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the accounts are disclosed in note 6.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

a) Property, plant and equipment:

Property, plant and equipment are stated at historical cost less accumulated depreciation and amortisation less impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the centre and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income and expenditure account during the financial period in which they are incurred.

Depreciation is calculated to write off the cost of property, plant and equipment over the period of their estimated useful lives on a straight line basis at the following annual rates:-

Furniture and fixtures	25%
Office equipment	25%
Leasehold improvement	25%

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

a) Property, plant and equipment: (cont'd)

The gain or loss on disposal or retirement of a property, plant and equipment recognised in the statement of comprehensive income, is the difference between the net sales proceeds and the carrying amount of the relevant asset.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

b) Cash and cash equivalents:

For the purpose of the cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short-term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the company's cash management.

c) Impairment of assets:

Assets that have an indefinite useful life are not subject to amortization, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

d) Payables:

Payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting could be immaterial, in which case they are stated at cost.

e) Government grant (LCSD allocation):

Government grants are recognised at their fair values where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that are intended to compensate. When the grant relates to depreciable asset, the fair value is presented as deferred income and is released to income in the statement of comprehensive income over the expected useful life of the relevant asset.

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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NOTES ON THE FINANCIAL STATEMENTS

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

f) Deferred income:

Sponsorships and other revenues received which are designated for the sole purpose of financing the operation of "the Fifth East Asian Games" ("the Games") are recognised in the balance sheet initially as deferred income. Sponsorship and other revenues that compensate the company for expenses incurred are recognised as revenue in the statement of comprehensive income on a systematic basis in the same period in which the direct and related expenses are incurred. Resultant surplus/deficit of the Games would be recognised in the statement of comprehensive income upon the completion and conclusion of the Games.

g) Provisions and contingent liabilities:

Provisions are recognised for liabilities of uncertain timing or amount when the company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow is remote.

h) Nominees transactions:

No account has been taken into account of assets and liabilities registered in the name of the company in respect of nominee transactions entered into by the company in the capacity as an agent for and on behalf of the principals.

i) Revenue recognition:

Government grant and sponsorship income are recognised on the basis as described in notes 4(e) and 4(f) respectively.

Licensing and merchandising income, broadcasting rights income and video wall promotion service income are recognised on an accrual basis, in accordance with the substance of the relevant agreements.

Banner promotion services income and revenue from charged accommodation are recognised when the relevant services are rendered.

Ticket sales and games concert income is recognised when the concert is held and finished.

Bank interest income is recognised as it accrues using the effective interest method.

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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NOTES ON THE FINANCIAL STATEMENTS

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

j) Related parties:

For the purposes of these financial statements, parties are considered to be related to the company if the company has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the company and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the company where those parties are individuals, the post-employment benefit plans which are for the benefit of employees of the company or of any entity that is a related party of the company.

k) Retirement benefits scheme:

The company joins a defined contribution retirement scheme under the Mandatory Provident Fund Schemes Ordinance (the "MPF Scheme") for those employees of the company.

The company's contributions to the MPF Scheme are made based on a percentage of the eligible employee's relevant income as defined in the Mandatory Provident Fund Schemes Ordinance. These contributions are expensed as incurred. The assets of the scheme are held separately from those of the company in independently administered funds.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

a) Financial risk factors:

The company's major financial instruments comprises accounts receivable, deposits, cash and bank balances, accounts payable and accrued expenses which arise directly from its operations. The company's risk associated with these financial instruments and policies on how to mitigate these risks are set out below:

i) Foreign exchange risk

The company does not have any significant exposure to foreign exchange risk. All of the receivables and payables are denominated in Hong Kong dollars and all other transactions are in Hong Kong dollars.

Due to the effect of the change in exchange rates is insignificant, the sensitivity analysis in respect of changes in exchange rates is not presented.

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONT'D)

a) Financial risk factors: (cont'd)

ii) Credit risk

The maximum exposure to credit risk without taking account of any collateral held is represented by the carrying amount of each financial asset in the balance sheet after deducting any impairment allowance, the company does not provide any other guarantees which would expose the company to credit risk.

The credit risk on such liquid fund is limited because the counterparties are reputable banks.

As at 31st March, 2010, the financial assets of the company that were exposed to credit risk and their maximum exposure were as follows:

	2010		2009	
	Carrying amount in balance sheet	Maximum exposure to credit risk	Carrying amount in balance sheet	Maximum exposure to credit risk
	HK\$	HK\$	HK\$	HK\$
Accounts receivable	14,772,624	14,772,624	117,054	117,054
Deposits	-	-	59,000	59,000
Cash and bank balances	<u>9,256,341</u>	<u>9,256,341</u>	<u>92,362,094</u>	<u>92,362,094</u>
	<u>24,028,965</u>	<u>24,028,965</u>	<u>92,538,148</u>	<u>92,538,148</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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NOTES ON THE FINANCIAL STATEMENTS

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONT'D)

a) Financial risk factors: (cont'd)

iii) Liquidity risk

Liquidity risk is the risk that funds will not be available to meet liabilities as they fall due, and it results from amount and maturity mismatches of assets and liabilities.

The company's policy is to regularly monitor current and expected requirements to ensure that it maintains sufficient reserve of cash to meet its liquidity requirements in the short and longer terms.

The following table details the remaining contractual maturities at the balance sheet date of the company's financial liabilities which are based on contractual undiscounted cash flows and the earliest date the company can be required to pay.

	2010		
	Carrying amount HK\$	Total contractual undiscounted cash flows HK\$	Within 1 year or on demand HK\$
Accounts payable and accrued expenses	1,066,506	(1,066,506)	(1,066,506)
	2009		
	Carrying amount HK\$	Total contractual undiscounted cash flows HK\$	Within 1 year or on demand HK\$
Accounts payable and accrued expenses	4,473,127	(4,473,127)	(4,473,127)

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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NOTES ON THE FINANCIAL STATEMENTS

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONT'D)

a) Financial risk factors: (cont'd)

iv) Interest rate risk

The company has no significant interest-bearing financial liabilities. The interest-bearing assets only include short-term bank balances and savings accounts. Short-term deposit carries interest at short-term deposit rates while savings accounts carry interest at floating rates. The company's income and operating cash flows are substantially independent of changes in market interest rates. Due to the fact that the changes in interest rate will have no material impact on the result of the company and accordingly the sensitivity analysis in respect of changes in interest rate is not presented.

b) Fair value estimation:

All financial instruments are carried at amounts not materially different from their fair values at 31st March, 2010 and 31st March, 2009.

6. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments used in preparing the accounts are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The resulting accounting estimates will, by definitions, seldom equal the related actual results. The estimates and assumptions that have a significant risks of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

a) Income taxes

The directors considers that the company has no tax liability in respect of its surplus arising from the Games as pursuant to the tripartite agreement with the Hong Kong government, all surplus of the company derived from the Games is required to be refunded to the government and therefore no provision for income tax has been made in these financial statements. Where the final tax outcome is determined and is different from the judgement made by the directors, such difference will impact the income tax and deferred tax provisions in the period in which such determination is made.

b) Property, plant and equipment

Management determines the estimated useful lives and residual values for the company's property, plant and equipment. Management will revise the depreciation charge where useful lives and residual values are different to previously estimated.

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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NOTES ON THE FINANCIAL STATEMENTS

7. PROPERTY, PLANT AND EQUIPMENT

	<u>Furniture and fixtures</u> HK\$	<u>Office equipment</u> HK\$	<u>Leasehold improvement</u> HK\$	<u>Total</u> HK\$
Cost				
At 1 st April, 2008	210,783	931,445	127,300	1,269,528
Additions	<u>50,351</u>	<u>308,945</u>	<u>125,700</u>	<u>484,996</u>
At 31 st March, 2009	261,134	1,240,390	253,000	1,754,524
Accumulated depreciation				
At 1 st April, 2008	91,530	390,177	31,825	513,532
Charge for the year	<u>65,283</u>	<u>310,098</u>	<u>63,250</u>	<u>438,631</u>
At 31 st March, 2009	156,813	700,275	95,075	952,163
Net book value				
At 31 st March, 2009	<u>104,321</u>	<u>540,115</u>	<u>157,925</u>	<u>802,361</u>
Cost				
At 1 st April, 2009	261,134	1,240,390	253,000	1,754,524
Additions	<u>25,390</u>	<u>626,323</u>	<u>-</u>	<u>651,713</u>
At 31 st March, 2010	286,524	1,866,713	253,000	2,406,237
Accumulated depreciation				
At 1 st April, 2009	156,813	700,275	95,075	952,163
Charge for the year	<u>71,631</u>	<u>466,678</u>	<u>63,250</u>	<u>601,559</u>
At 31 st March, 2010	228,444	1,166,953	158,325	1,553,722
Net book value				
At 31 st March, 2010	<u>58,080</u>	<u>699,760</u>	<u>94,675</u>	<u>852,515</u>

8. ACCOUNTS RECEIVABLE

Accounts receivable mainly represents sponsorship income receivable from The Hong Kong Jockey Club Charities Trust, licensing and merchandising income, Games Magazine income and video wall promotion income receivable. The management believes that no impairment allowance is necessary in respect of these balances and the balances can be fully recoverable. The company does not hold any collateral over these balances.

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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NOTES ON THE FINANCIAL STATEMENTS

9. CASH AND BANK BALANCES

	<u>2010</u> HK\$	<u>2009</u> HK\$
Time deposits	-	35,000,000
Cash at bank	9,252,192	57,350,554
Cash in hand	<u>4,149</u>	<u>11,540</u>
	<u>9,256,341</u>	<u>92,362,094</u>

Cash balances held in savings accounts at banks earn interest at floating rates based on daily bank deposit rates.

Short-term deposits were made for various earned interest at the respective short-term time deposits rates.

10. GOVERNMENT GRANT - LCSD ALLOCATION

	<u>2010</u> HK\$	<u>2009</u> HK\$
Amount recognised during the year (note 15)	<u>113,350,000</u>	<u>-</u>

The total government fund for the Games as approved by the Legislative Council was HK\$123 million out of which HK\$9,650,000 was allocated to organisations other than the company for specific purposes as detailed below, leaving a balance of HK\$113,350,000 allocated to the company.

<u>Name of payee</u>	<u>Purposes</u>	<u>Amount</u> HK\$
Sports Federation & Olympic Committee of Hong Kong, China	Setting up of the East Asian Games Association Secretariat	7,000,000
Radio and Television of Hong Kong	Production of 1-year countdown programme	650,000
Electrical and Mechanical Services Department	Provision of technical support services for the Games	<u>2,000,000</u>
		<u>9,650,000</u>

The funds of HK\$9,650,000 allocated to the above organisations and the relevant expenditure incurred by them in connection with the Games had not been reflected in these financial statements.

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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NOTES ON THE FINANCIAL STATEMENTS

11. SPONSORSHIP INCOME

	<u>2010</u> HK\$	<u>2009</u> HK\$
Amount recognised during the year (note 15)	79,798,200	12,442,472

In the opinion of the directors, sponsorships-in-kind other than cash are not reflected in these financial statements.

12. EXPENDITURE

	<u>2010</u> HK\$	<u>2009</u> HK\$
a) Staff costs		
Salaries	18,684,438	15,428,427
Mandatory provident fund contributions	633,010	450,420
Incentive pay/gratuity	3,562,805	-
Mobile phone fee subsidy	296,123	36,322
	<u>23,176,376</u>	<u>15,915,169</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
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NOTES ON THE FINANCIAL STATEMENTS

12. EXPENDITURE (CONT'D)

	<u>2010</u> HK\$	<u>2009</u> HK\$
b) Administrative expenses		
Advertisement	88,593	119,805
Auditors' remuneration	110,000	15,000
Bank charges	10,582	3,851
Business registration fee	6,698	733
Contingency	484,398	816,334
Cleaning and utensils	5,300	1,100
Depreciation	601,559	438,631
Equipments	279,611	-
Gifts and entertainment	5,233	37,820
Insurance	1,084,216	306,688
Legal and professional fees	1,750,557	1,184,580
Licence fees	250	1
EAG magazine	260,315	300,070
Newspaper and periodicals	12,608	11,889
Office supplies	850	31,202
Postage and express	123,933	16,426
Printing and stationery	671,413	191,673
Proshop expense	41,000	4,950
Repairs and maintenance	155,548	41,256
Staff training and uniform	16,565	57,160
Telephone, fax and internet	491,624	114,883
Transportation	51,729	6,000
Travelling expenses	26,532	2,294
Miscellaneous	93,712	2,078
	<u>6,372,826</u>	<u>3,704,424</u>
c) Volunteers		
Allocation to Agency for Volunteer Service	3,230,373	3,072,400
Gift and entertainment	-	266
Printing and stationery	44,650	26
Website maintenance	272,100	310,000
Postage and express	-	880
Meal box for volunteers	685,820	-
Uniforms	2,147,990	-
Travelling	3,148	300
Insurance	76,300	-
Programme legacy	51,848	765,991
Miscellaneous	105,690	2,478
	<u>6,617,919</u>	<u>4,152,341</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

12. EXPENDITURE (CONT'D)

	<u>2010</u> HK\$	<u>2009</u> HK\$
d) Competition event expenses		
Gifts and express	5,620	4,745
Postage and express	21,165	411
Printing and stationery	194,985	601
Transportation	19,346	-
Travelling expenses	24,355	8,897
Miscellaneous expenses	24,196	2,554
Programme expenses	<u>27,651,551</u>	<u>540,567</u>
	<u>27,941,218</u>	<u>557,775</u>
e) Publicity and marketing expenses		
Advertisement	56,940	72,930
AV and photography	48,369	3,400
Gifts and entertainment	25,244	24,945
Newspaper and periodicals	6	162
Postage and courier	25,457	2,746
Printing and stationery	45,738	132,691
Programme expenses	3,581,591	2,348,319
Transportation	12,422	2,116
Travelling expenses	17,408	7,100
Miscellaneous	<u>40,771</u>	<u>3,820</u>
	<u>3,853,946</u>	<u>2,598,229</u>
f) Broadcasting and logistics expenses		
Gifts and entertainment	-	10,000
Postage and courier	-	4,213
Printing and stationery	2,101	215
Programme expenses	58,275,749	-
Transportation	14,333	-
Travelling expenses	17,481	3,994
Miscellaneous	<u>19,481</u>	<u>629</u>
	<u>58,329,145</u>	<u>19,051</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

12. EXPENDITURE (CONT'D)

	<u>2010</u> HK\$	<u>2009</u> HK\$
g) Ceremonies and VIP hospitality		
AV and photography	1,000	-
Gifts and entertainment	9,368	8,593
Overseas meeting	9,118	-
Postage and express	9,240	653
Printing and stationery	26,422	2,403
Opening ceremonies	57,885,693	-
Closing ceremonies	3,400,926	-
Hospitality	2,581,762	-
Programme expenses	1,942,336	108,695
Transportation	22,923	125
Travelling expenses	44,115	5,131
Miscellaneous	58,097	3,624
	<u>65,991,000</u>	<u>129,224</u>
h) Information Technology		
Games result management	11,271,443	-
Contingency (rent of walkie talkie)	6,000	-
Provision of PC equipment support service during Games period (Computer rent at site)	1,086,592	-
	<u>12,364,035</u>	<u>-</u>
i) Accreditation and security		
Project based staffing	730,273	-
Guard service engagement	8,430,627	-
Accreditation centre setup	1,035,577	-
Crowd management equipment	249,702	-
Other accreditation expenses	147,220	-
	<u>10,593,399</u>	<u>-</u>
j) Medical services and anti-doping		
Administrative cost	3,855	-
Doping control	2,130,953	-
Medical services	318,045	-
	<u>2,452,853</u>	<u>-</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

13. INCOME TAX EXPENSE

No provision for Hong Kong profits tax has been made in these financial statements as the company sustained a loss for tax purpose for the years ended 31st March, 2010 and 31st March, 2009.

No provision for deferred tax assets amounting to HK\$228,042 (2009: HK\$167,786) in respect of the unrelieved tax loss has been provided in these financial statements as the unpredictability of future profits stream.

14. DIRECTORS' REMUNERATION

None of the directors, who are also considered as key management of the company, received or will receive any fees or other emoluments in respect of their services to the company during the year (2009: Nil).

15. DEFERRED INCOME

Deferred income comprises:

a) Government grant

This represents the unutilized amount of government grant received from Leisure & Cultural Services Department ("LCSD") of the Government of Hong Kong Special Administrative Region.

Pursuant to the Tripartite Agreement for the Fifth East Asian Games entered into among the company, the Government of the Hong Kong Special Administrative Region and the Sports Federation and Olympic Committee of Hong Kong, the budget for the organisation, implementation and delivery of the Games is HK\$240 million. With the approval of the Legislative Council, the Government will provide up to a maximum of HK\$123 million. Upon the conclusion of the Games, the company is required to return the surplus, if any, up to the total amount of Government grant provided.

Up to 31st March, 2010, the company had received a sum of HK\$113,350,000 (2009: HK\$59,148,302) from Leisure & Cultural Services Department of the Government of Hong Kong Special Administrative Region (see note 10).

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

15. DEFERRED INCOME (CONTD)

b) Sponsorships

This represents the unutilized amount of sponsorships and other revenues received for financing the operations of the Games in Hong Kong after deducting the direct and related expenses incurred.

c) Details of the movements in the accounts during the year are as follows:

	2010		
	Government grant – LCSD allocation HK\$	Sponsorships HK\$	Total HK\$
Balance brought forward	59,148,302	29,787,581	88,935,883
Receipts during the year	54,201,698	59,761,652	113,963,350
Receivable from HKJCCT	-	14,057,584	14,057,584
	<u>113,350,000</u>	<u>103,606,817</u>	<u>216,956,817</u>
Amount recognised as income (notes 10 and 11)	<u>(113,350,000)</u>	<u>(79,798,200)</u>	<u>(193,148,200)</u>
Balance carried forward	<u>-</u>	<u>23,808,617</u>	<u>23,808,617</u>

	2009		
	Government grant – LCSD allocation HK\$	Sponsorships HK\$	Total HK\$
Balance brought forward	20,438,896	14,347,312	34,786,208
Receipts during the year	<u>38,709,406</u>	<u>27,882,741</u>	<u>66,592,147</u>
	59,148,302	42,230,053	101,378,355
Amount recognised as income (notes 10 and 11)	<u>-</u>	<u>(12,442,472)</u>	<u>(12,442,472)</u>
Balance carried forward	<u>59,148,302</u>	<u>29,787,581</u>	<u>88,935,883</u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

16. ACCUMULATED FUND

	<u>2010</u> HK\$	<u>2009</u> HK\$
Balance brought forward	6,357	6,357
Surplus for the year	<u>-</u>	<u>-</u>
Balance carried forward	<u><u>6,357</u></u>	<u><u>6,357</u></u>

Pursuant to the agreement between the company and the government, all such surplus has to be refunded to the government upon the completion and conclusion of the Games.

17. RELATED PARTY TRANSACTIONS

There were no related party transactions conducted by the company during the year.

18. NOMINEES TRANSACTIONS

Pursuant to the agreement for Temporary Overlay on EAG Completion Venues made between the government and the company dated 28th November, 2008, the company was funded from LCSD a sum to the extent of approximately HK\$71 million for the project of implementing certain temporary overlay and thematic design works for the Games. The actual sum would be subject to confirmation by the government. The company was acted as an agent of the project of which all the respective transactions were carried out by the company as nominee on behalf of the government and thus had not been accounted for in these financial statements.

As at 31st March, 2010, a total sum of HK\$44,271,482 had been received and expended by the company for the project. Details of these nominee transactions are set out below.

	<u>2010</u> HK\$	<u>2009</u> HK\$
Amount received from LCSD	44,271,482	-
Less: Amounts paid to suppliers of the project	<u>(44,271,482)</u>	<u>-</u>
	<u><u>-</u></u>	<u><u>-</u></u>

2009 EAST ASIAN GAMES (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability by guarantee)

NOTES ON THE FINANCIAL STATEMENTS

19. CONTINGENT LIABILITIES

Pursuant to the tripartite agreement between the company and the government, within six months of the conclusion of the Games or any sooner termination of such agreement, surplus funding from the Games, if any, up to the total amount of government subsidy/grant provided and hiring charges waived, shall be returned to the government.

20. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31ST MARCH, 2010

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendment, new standards and interpretations which are not yet effective for the accounting year ended 31st March, 2010 but which have not been adopted in these financial statements.

The company is in the process of making an assessment of what the impact of these amendments, new standards and new interpretation is expected to be in the period of initial application. So far it has concluded that the adoption is unlikely to have a significant impact on the company's results of operations and financial position.

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12 May 2011

Ms Miranda Hon
Clerk to the Public Accounts Committee
Legislative Council
Legislative Council Building
8 Jackson Road, Central
Hong Kong

Dear Ms Hon,

**The Director of Audit's Report on the
results of value for money audits (Report No. 56)
Hong Kong Export Credit Insurance Corporation (ECIC)**

Thank you for your letter dated 19 April 2011.

Based on the information available from relevant websites and documents accessible to the public, we have examined the operations of export credit agencies (ECAs) in 10 different countries in the Asia Pacific, Europe and North America. All of these ECAs, except for the one in Singapore which has been privatized in 2003, are 100% owned by the respective governments and are members of the Berne Union which is the leading international organisation of public and private sector providers of export credit and investment insurance.

The listed ECAs are established in different forms, e.g. as government departments, public corporations, banks or as a publicly listed company. However, none of them have functions which are identical to the ECIC. All offer products and services (including loans, project financing, investment insurance and banks guarantees) wider than the

ECIC. A table comparing the products and services offered by the ECIC and the other ECAs, and a description of their governance structure is at **Annex**. It is noted that the ECA in New Zealand which performs functions most similar to the ECIC has an advisory board structure.

In view of the more focused services offered by the ECIC, we consider that the present governance structure of the ECIC is appropriate.

A Chinese translation of our response is attached as requested. Soft copies have been sent to you separately. If you have any enquires, please feel free to contact the undersigned or Mr Cyril Leung at 2918 7473.

Yours sincerely,



(Mrs Candy Yeung)
for Secretary for Commerce and Economic Development

c.c. Commissioner, Hong Kong Export Credit Insurance Corporation
(fax no. 2311 8446)
Secretary for Financial Services and the Treasury (fax no. 2147 5239)
Director of Audit (fax no. 2583 9063)

ECIC and 10 Overseas Export Credit Agencies (ECA)

Name of Economy/Country		Governance Structure	Products and Services Offered										
Name of ECA			A ¹	B ²	C ³	D ⁴	E ⁵	F ⁶	G ⁷	H ⁸	I ⁹	J ¹⁰	K ¹¹
1.	Hong Kong Hong Kong Export Credit Insurance Corporation (ECIC)	Advisory Board of a Statutory Body <ul style="list-style-type: none">Set up under the ECIC Ordinance, to advise the ECIC in the conduct of its business since 1966. The Advisory Board consists of nine members from different industries such as manufacturing, banking, insurance, services, import and export, an official from CEDB and ex-officio representing Trade Development Council and the office of the Commissioner of Insurance.	✓	✓									
2.	New Zealand New Zealand Export Credit Office (NZECO)	Advisory Board of a Government Department <ul style="list-style-type: none">Founded in 2001, the NZECO Advisory Board consists of three members from the business sector. It advises New Zealand's Secretary to the Treasury on issues such as the operation and performance of the NZECO, the effectiveness of risk management strategies and auditing and reporting requirements. All transactions are assessed by NZECO's underwriters and then recommendations are made to the NZECO Advisory Board. If a transaction is accepted by the NZECO Advisory Board, a recommendation is made to the Secretary to the Treasury (or delegate) to approve a transaction.	✓	✓				✓					

Name of Economy/Country		Governance Structure	Products and Services Offered										
Name of ECA			A ¹	B ²	C ³	D ⁴	E ⁵	F ⁶	G ⁷	H ⁸	I ⁹	J ¹⁰	K ¹¹
3.	United Kingdom Export Credits Guarantee Department (ECGD)	Management Board of a Government Department <ul style="list-style-type: none">Founded in 1919, the ECGD is a separate department of the UK Government, responsible to the Secretary of State for Business, Innovation & Skills. The Board is made up of a non-executive chairman, five non-executive directors and five executive directors including the Chief Executive of the ECGD. While the ECGD Management Board advises and supports the Chief Executive in operating the ECGD, it is accountable to the Secretary of State for Business, Innovation & Skills for overseeing the work of the Chief Executive and the senior management team.	✓	✓	✓			✓				✓	
4.	Australia Export Finance and Insurance Corporation (EFIC)	Board of Directors of a Public Corporation <ul style="list-style-type: none">Founded in 1957, the EFIC is governed by a Board of nine members. Apart from the Managing Director, who is a full time employee appointed by the Board after consulting the Minister for Trade, all Board members are non-executives appointed by the Minister. The majority of the Board members is from the private sector, with the Secretary of the Department of Foreign Affairs and Trade representing the Australian Government. The Board is responsible for the corporate	✓	✓	✓	✓	✓	✓					✓

Name of Economy/Country		Governance Structure	Products and Services Offered										
Name of ECA			A ¹	B ²	C ³	D ⁴	E ⁵	F ⁶	G ⁷	H ⁸	I ⁹	J ¹⁰	K ¹¹
		governance of the EFIC and oversees its operations, which include formulating strategies, defining risk appetite, monitoring performance, making decisions on capital usage and making dividend recommendations to the Government.											
5.	Canada Export Development Canada (EDC)	Board of Directors of a Public Corporation <ul style="list-style-type: none">Founded in 1944, the Board is responsible for the strategy and management of the EDC. It oversees the EDC's strategic direction, as outlined in its Corporate Plan, to ensure that it meets its public policy objectives in the most effective manner. The Board reports to Parliament through the Minister for International Trade. The Board has 12 members who are appointed by the Government of Canada, mainly comprising representatives from the private sector. All Board members other than the CEO are non-executives. The allocation of responsibilities between the Board and management is reviewed on a regular basis.	✓	✓	✓	✓		✓					✓
6.	Denmark Eksport Kredit Fonden (EKF)	Board of Directors of a Public Corporation <ul style="list-style-type: none">Founded in 1996, the EKF's Board of Directors consists of eight members appointed by the Minister for Economic and Business Affairs. Most of the members of the Board of Directors are from the business sector, selected on the	✓	✓	✓			✓	✓			✓	

Name of Economy/Country		Governance Structure	Products and Services Offered										
Name of ECA			A ¹	B ²	C ³	D ⁴	E ⁵	F ⁶	G ⁷	H ⁸	I ⁹	J ¹⁰	K ¹¹
		basis of their professional background and knowledge of the market in which the EKF operates. In order to ensure that business and trade policy interests are promoted, the Ministry of Economic and Business Affairs, the Ministry of Finance and the Ministry of Foreign Affairs are represented on the Board.											
7.	India Export Credit Guarantee Corporation of India Ltd (ECGC)	Board of Directors of a Public Corporation <ul style="list-style-type: none">Founded in 1957, the Board is responsible for the strategy and operation of the ECGC. The Board is presided over by a full time Chairman-cum-Managing Director. The other directors on the Board are non-executives. All appointments to the Board, including that of the Chairman-cum-Managing Director are made by the Government.	✓	✓	✓	✓				✓	✓		
8.	Japan Nippon Export and Investment Insurance (NEXI)	Board of Directors of a Public Corporation <ul style="list-style-type: none">Established in April 2001, NEXI is an incorporated administrative agency and is managed by a Board of Directors of four members, all of whom are the executive officers of NEXI, including the Chairman and CEO, two Vice-Chairman, and one Corporate Auditor.	✓	✓	✓			✓				✓	

Name of Economy/Country		Governance Structure	Products and Services Offered										
			A ¹	B ²	C ³	D ⁴	E ⁵	F ⁶	G ⁷	H ⁸	I ⁹	J ¹⁰	K ¹¹
9.	Malaysia Export-Import Bank of Malaysia Berhad (EXIM Malaysia)	Board of Directors of a Bank <ul style="list-style-type: none">Founded in 1977, the Board of Directors is responsible for policy and strategic issues, the review of financial performance and credit operations. The Board has seven members from the business sector and the government.	✓	✓	✓	✓		✓					✓
10.	USA Export Import Bank of the United States (US EXIM)	Board of Directors of a Bank <ul style="list-style-type: none">Founded in 1934, the Board of Directors adopts, and may from time to time amend, such bylaws as are necessary for the proper management and functioning of the Bank, and through the bylaws, designates the vice presidents and other officers of the Bank and prescribes their duties. The Board consists of seven members including the President of the Bank as the Chairman of the Board and two ex-officio (Secretary of Commerce and US Trade Representative). Some Board members are appointed by the President of the United States with the advice and consent of the Senate.	✓	✓		✓			✓				✓
11.	Singapore ECICS Limited (ECICS)	An ex-ECA: Board of Directors of a Publicly Listed Company <ul style="list-style-type: none">The ECICS was originally a public body.Founded in 2003, the ECICS is a privately	✓	✓			✓	✓		✓			

Name of Economy/Country		Governance Structure	Products and Services Offered										
Name of ECA			A ¹	B ²	C ³	D ⁴	E ⁵	F ⁶	G ⁷	H ⁸	I ⁹	J ¹⁰	K ¹¹
		owned company which provides a broad range of credit insurance and, bonds and guarantees services. Its shares are 100% owned by publicly-listed IFS Capital Limited, a recognized financial institution which specializes in short and long-term financing services. The operation of the ECICS is governed by the Insurance Act Chapter 142 and the Insurance Regulations and the Government has no involvement in its insurance business.											

Note

1. Export credit insurance protecting exporters against risks of nonpayment for or refusal of shipments by customers overseas due to commercial or political events.
2. Guarantees on payment of a debt or performance of some obligations if the performer primarily liable fails to perform.
3. Investment insurance covering a number of long-term political risks, potentially affecting the value or performance of an overseas investment. The insurance programmes may differ in different countries but are generally based on the same principle to cover the investor against the political risks in connection with their overseas investment.
4. Financing services including direct loans and financing for projects.
5. Bonds similar to a bank guarantee.
6. Bond insurance protecting the exporter against the risk of unfair calling under a contract guarantee issued in favor of the buyer. The unfair calling cover under the insurance protects the exporter should the buyer's demand in itself be unfair due to political events in that country.
7. Export loans to help export companies when foreign buyers are unable to secure credit facilities from banks for purchasing the exporters' products and services.
8. Domestic credit insurance covering a wide range of commercial risks including, such as refusal of a customer to pay or accept goods, bankruptcy, insolvency and contract cancellation.
9. Export factoring, a form of short term finance where a finance company (the factor) purchases the seller's receivables and assumes the credit risk, either with or without recourse to the seller.
10. Project finance insurance, a guarantee solution which may be offered to project suppliers, and their international customers, covering limited recourse lending.
11. Project finance in the form of loan disbursements, generally made directly to suppliers and contractors, to support investors and contractors undertaking usually overseas projects in areas such as infrastructure, manufacturing and other developmental projects.

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23 May 2011

Ms Miranda Hon
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Legislative Council Building
8 Jackson Road, Central
Hong Kong

Dear Ms Hon,

**The Director of Audit's Report on the
results of value for money audits (Report No. 56)**

**Hong Kong Export Credit Insurance Corporation ("ECIC")
(Chapter 6)**

Thank you for your letter dated 18 May 2011.

Regarding the issues raised by the Audit Commission in paragraph 2.6 of the Audit Report, we would like to set out below the actions which have already been taken or are being implemented by the ECIC and the Commerce and Economic Development Bureau ("CEDB") based on the existing governance structure of the ECIC.

Rapid Business Expansion

Both CEDB and the Advisory Board of the ECIC will continue to monitor closely the growth of the ECIC's insured business and

ensure that the Government's guarantee remains sufficient for it to carry its statutory duties effectively. It is noted that with the gradual recovery of the global economy, the increase in demand for the ECIC's services has slowed down significantly.

Role of Advisory Board

As stated in its response to para 2.21(a) of the Audit Report, the ECIC is reviewing its guidelines for determining the types of issues (and the timeframe) which should be submitted to the Advisory Board and its Committees for advice and will seek the Advisory Board's endorsement on these guidelines upon the completion of the review. Meanwhile, the Advisory Board discussed and agreed at its meeting held on 23 March 2011 on the issues to be submitted to the Advisory Board for information and advice for all meetings scheduled in 2011-12.

Role of CEDB

While the present mechanism already enables the ECIC to incorporate the Government's views into its annual corporate plan/budget through discussions at the Advisory Board, we have asked the ECIC to submit its annual corporate plan/budget to SCED for formal approval from this year onwards after seeking the endorsement of the Advisory Board.

Scope of ECIC's Services under the ECIC Ordinance

In response to the recommendation in para 4.58 of the Audit Report, CEDB has sought legal advice which reconfirmed that the services provided by the ECIC are consistent with the true intent, meaning and spirit of section 9(3) of the ECIC Ordinance (Cap. 1115).

Monitoring of the ECIC's Work and Performance

While CEDB currently does not micro-manage the daily operations of the ECIC, we have recently reviewed the situation and have further stepped up our monitoring by requiring the ECIC to submit its annual corporate plan/budget to SCED for formal approval from this year onwards, after seeking the endorsement of the Advisory Board. As regards

the half-yearly housekeeping meeting between the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) and the ECIC, in addition to its business and financial performance, the ECIC also reports regularly on its management and operational matters including internal audit, human resource management, reinsurance arrangement and development plans for new services. We will continue to assess through the annual corporate plan/budget and our regular liaison and housekeeping meetings with the ECIC how effectively the ECIC discharges its public mission.

Administration Irregularities Identified

In 2009, the ECIC commissioned a consultancy study on the internal control procedures of the ECIC on a number of areas including tendering and disbursement of IT development and consultancy projects. A number of administration irregularities were identified. All of the consultant's recommendations to address the irregularities had been implemented in the same year before the Director of Audit commenced its value for money audit on the ECIC. Since then, the ECIC has regularly reviewed its internal control. An internal audit unit was set up in 2010 to audit the work of each division of the ECIC and its plan is to complete a full internal audit within three years. It will submit a report on each division to the Audit Committee (under the Advisory Board) which will, in turn, put forward its recommendations to the full Board for consideration.

The Administration's response in Para 2.8(a) of the Audit Report

As stated in our letter to the Public Accounts Committee on 12 May 2011, the findings on the governance structure and operation of overseas export credit agencies (ECAs) are based on information in websites and documents available to the public. To get a better understanding of the governance and operations of these ECAs, we will ask the ECIC to write to these ECAs for more information. Upon receipt of additional data from these organizations, we will further review the governance of the ECIC and report back to the Panel on Commerce and Industry of the Legislative Council on the outcome of the review.

I hope the above will address the concerns of the Public Accounts Committee.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Candy', with a stylized flourish extending from the end.

(Mrs Candy Yeung)
for Secretary for Commerce and Economic Development

c.c. Commissioner, Hong Kong Export Credit Insurance Corporation
(fax no. 2311 8446)
Secretary for Financial Services and the Treasury (fax no. 2147 5239)
Director of Audit (fax no. 2583 9063)

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26 May 2011

Ms Miranda Hon
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8 Jackson Road, Central
Hong Kong

Dear Ms Hon,

**The Director of Audit's Report on the
results of value for money audits (Report No. 56)**

**Hong Kong Export Credit Insurance Corporation ("ECIC")
(Chapter 6)**

Thank you for your letter dated 25 May 2011.

The Administration plans to report the outcome of the review of the governance of the ECIC to the Panel on Commerce and Industry of the Legislation Council before end 2011.

Yours sincerely,

(Mrs Candy Yeung)
for Secretary for Commerce and Economic Development

c.c. Commissioner, Hong Kong Export Credit Insurance Corporation
(fax no. 2311 8446)
Secretary for Financial Services and the Treasury (fax no. 2147 5239)
Director of Audit (fax no. 2583 9063)

Public Accounts Committee of the Legislative Council

(12 May 2011)

Report No. 56 of the Director of Audit

Chapter 7: Hong Kong Housing Authority :

Management of Commercial Properties

Speaking Points of the Director of Housing

Chairman,

The Housing Department is the executive arm of the Hong Kong Housing Authority. As such, we are responsible for managing some 710 000 public rental housing flats and 169 000m² of commercial and retail premises. As the Director of Audit knows, I welcome this study as an important adjunct to our own internal auditing system. The independent oversight that is provided by the Director of Audit and his colleagues is an integral part of our systems of checks and balances.

2. The Housing Department is tasked to implement policy determined by the Housing Authority. In this regard, I am pleased to see that the Report confirms that, in line with the direction given by the Housing Authority, the Department has taken a number of initiatives to maximise the use of surplus retail and car parking facilities and reduce vacancy rates through conversion and market re-ordering exercises. The surplus provision of these facilities has mainly come about as a result of factors beyond our control, such as the ageing population in our older public rental housing estates, competition from nearby new developments, the outdated design of many of our facilities and of course the expansion of the public transport network. Nevertheless, we continuously strive to ensure that such facilities are used in a manner that is best able to provide the services that our residents expect.

3. Despite the divestment of commercial properties in 2005, the Housing Department still manages a wide portfolio of commercial and non-domestic properties which comprises 1 800 shops, 1 100 shopstalls, 900 educational facilities and Government lettings, 6 800 welfare premises, 8 400 factory units

and 27 000 parking spaces in public rental housing estates, Home Ownership Scheme courts and Tenants Purchase Scheme estates scattered around the territory. About 70% of the retail facilities are managed by property services agents.

4. I note that the Report contains a recommendation that we should carry out a review of the 2005 divestment exercise. We agree with this recommendation and, since the final transfers of legal title which took place in July last year, we are now preparing to carry out the review.

5. With such a large-scale operation, we recognise that there will be room for improvement in the day-to-day management of the Housing Authority commercial facilities, and we do constantly review our operations. However, I must point out that in certain circumstances, in particular in cases of deliberate abuse of lease conditions, or criminal activities, for example those associated with organised gambling, my colleagues on the ground may not be in the best position to take action. In such cases, we will bring in the relevant law enforcement agency and work with them. This does not mean to say that we are in any way complacent and are not taking steps to tackle irregularities. Indeed, since the introduction of the Marking Scheme in 2003, we have handled a total of 408 cases where demerit points have been awarded for breaches of the tenancy conditions. In the last year, we have issued one notice-to-quit under the Marking Scheme and another two for breach of tenancy agreement. As a result, we have recovered three premises altogether. As an on-going measure, we have implemented independent checks on site and have stepped up action against any irregularities found. This is, of course, in addition to action taken following successful criminal prosecutions.

6. Any system is only as good as the people who administer it. For this reason, we have been working closely with colleagues as well as staff of the property services agents to ensure that they understand the requirements and follow up properly. One issue that we work hard to balance is the challenge to encourage staff to use their judgement when enforcing our rules while minimising the risk of corruption or malfeasance. This is where the appropriate checks and balances come into play. While we strive to operate in a properly commercial manner, we must also have regard to our social and community responsibilities. This is a difficult balancing act and we have to work hard to try to get it right.

7. As I said earlier, I welcome the audit review of the management of the Housing Authority commercial properties by the Housing Department. I want to express my appreciation for the professional manner in which this exercise was carried out and, in particular, for the opportunity the Department has been given to respond to some of the findings and to clarify many points ahead of the finalisation of the Report. As Members can see for themselves, we have generally accepted the recommendations and these have either already been implemented or will be in due course. Where policy clearance is required, we will of course seek approval from the Housing Authority or its sub-committees.

8. We have prepared some supplementary information sheets and a checklist on cases identified in the Report to help Members understanding of the commercial operations undertaken by the Housing Department on behalf of the Housing Authority.

9. With such a large portfolio to manage, my colleagues and I will continue to do our best to provide a high standard of management services to our tenants. We never forget that we must provide a range of services to our residents and tenants and we must do so to the best of our ability.

10. Thank you.

Director of Audit's Report No. 56 (Chapter 7)**Hong Kong Housing Authority :
Management of Commercial Properties****Supplementary Information Sheets for PAC Members**

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May 2011

◆ **Terms of Reference of Commercial Properties Committee (CPC)**

- ✧ To advise the Housing Authority on policies concerning its commercial, industrial and other non-domestic facilities and to optimise financial return on its investment.
- ✧ To exercise the powers and functions of the Authority in accordance with the relevant prevailing policies –
 - to endorse programmes of activities and monitor their performance, and to approve the financial targets, service standards and performance measures within the policies and objectives set by the Authority for submission to the Authority for approval;
 - to manage and maintain the Authority's non-domestic properties, including determination of letting and promotional strategy, rents and other tenancy terms; and
 - to determine ex-gratia allowances for non-domestic properties affected by redevelopment, repair or other operational activities.

◆ **Property Portfolio**

Type	No. of units	No. of tenancies	Internal floor area (m ²)	Occupancy rate
Domestic premises : 710 000 public rental housing (PRH) units				
Retail Premises				
- Shops	1 800	1 400	169 000	95%
- Shopstalls	1 100	840		91%
- Cooked food stalls	45*	35		78%
Factory	8 400	3 500	209 000	99%
Welfare premises	6 800	1 300	654 000	95%
Educational facilities & government lettings	900	530	1 500 000	95%
Total	19 045	7 605	2 532 000	95%
Storeroom	2 800	-	-	-
Parking spaces	27 000	-		75%

* CPC approved to defrost letting of 10 cooked food stalls in early 2011.

◆ **Marking Scheme**

- ✧ Launched since 2003 and reviewed in 2006.
- ✧ Covers nine misdeeds incorporating all environmental hygiene related breaches.
- ✧ Allotment of points ranging from three to seven points and termination of tenancy with accumulation of 16 points or more.

◆ **Enforcement Actions Taken in Last Year**

- ✧ No. of referrals on illegal gambling made to the Police : 150
- ✧ No. of warning letters on unauthorised use of leased premises : 1 500
- ✧ No. of notice-to-quits (NTQs) issued : 2

◆ **Leasing Mode**

- ✧ Tenders viz. Open Rental Tender, Open Instant Tender, Premium Tender and Restricted Instant Tender.
- ✧ Direct Negotiation for large-space lettings to achieve magnetic effect from anchor tenants and get better assurance of good performance.
- ✧ Walk-in Application and Direct Allocation may also be adopted for unpopular premises and letting of commercial premises to non-government organisations (NGOs) at fair market rent.

◆ **Planning Standard for Provision of Private Car Parks**

- ✧ 1 space for 5-8 Home Ownership Scheme (HOS) flats and 1 space for 13-16 PRH flats (1996 – 2002)
- ✧ 1 space for 13-24 PRH flats (2003 – 2008)
- ✧ 1 space per 26-46 PRH flats adopted since 2009

◆ **3-Tier Charging System for Private Car Parks**

- ✧ First tier : full monthly charges shall apply for those car parks with occupancy rates at 90% or above.
- ✧ Second tier : a reduction of about 10% from the full monthly charges will be given for those car parks with occupancy rates at 50% to below 90%.
- ✧ Third tier : a reduction of about 15% from the full monthly charges will be given for those car parks with occupancy rates below 50%.

◆ **2005 Divestment**

- ✧ Number of properties divested : 180
- ✧ Number of estates/courts involved : 176
- ✧ Date of listing : 25 November 2005
- ✧ Divested Property Portfolio
 - About 11 million ft² (internal floor area) of retail spaces
 - Some 79 000 parking spaces

◆ **Key Performance Indicators (KPIs) of Commercial Operation**

KPIs		Targets		
		2009/10	2010/11	2011/12
(a)	Vacancy rate for retail premises	Below 5.5%	Below 5.5%	Below 5%
(b)	(i) Operating expenditure as a percentage of income (including depreciation and rates)	Below 67%	Below 62%	Below 60%
	(ii) Operating expenditure per square metre retail space per month (excluding depreciation and rates)	Below \$125	Below \$115	Below \$135
	(iii) Operating expenditure per unit car park space per month (excluding depreciation and rates)	Below \$245	Below \$245	Below \$280
(c)	Amount of rent arrears	Less than 5%	Less than 4.5%	Less than 3.0%

◆ **Cases Checklist (as at 30.4.2011)**

Irregularities Identified	Case Detail	Progress
Case 1 - Photo 1 (para. 2.9)	Adjacent storerooms used for playing mahjong	The two storerooms were surrendered on 31.1.2011. We have extended the unit-to-unit inspection exercise to cover all 2 800 storerooms.
Case 1 - Photo 2 (para. 2.9)	Storeroom used as an office	The storeroom was recovered on 31.3.2011. The Property Services Agent of the estate concerned was warned for the unsatisfactory performance in detecting the irregularities. Should its performance remain unsatisfactory, we will deduct the assessment marks which which has impacts on its chance for future tendering.
Photo 3 (para. 2.12)	Mahjong playing at a market stall in an estate in Kowloon	HD served a NTQ to terminate the tenancy of the stall on 31.3.2011 and the case is pending hearing by the Appeal Panel, tentatively scheduled for June 2011.
Photo 4 (para. 2.12)	Tin kau playing at a common area of a shopping centre on Hong Kong Island	The management has stepped up daily patrol and liaised with the Police for operations against gambling activities. We also worked with the local NGO to reach out to the group of senior citizens persuading them to refrain from gambling and participate the activities organised by NGO.

Irregularities Identified	Case Detail	Progress
Photo 5 (para. 2.15)	Cases of non-trading during normal business hours at an estate in Kwai Chung	We continue to keep daily records on opening hours of the suspected non-trading premises and will take tenancy actions, if required.
Photo 6 (para. 2.15)	Cases of non-trading during normal business hours at an estate in Tsuen Wan	We continue to keep daily records on opening hours of the suspected non-trading premises and will take tenancy actions, if required.
Photo 7 (para. 2.19)	Obstruction problem at an estate on Hong Kong Island	HD has issued warnings and allotted six points to the tenants concerned. We will intensify the enforcement action under the Marking Scheme, including the deployment of the Mobile Operations Unit to assist the local management to take operations against shopfront obstruction.
Case 2 (para. 2.28)	Re-designation of trades in a shopping centre on Hong Kong Island	We are in the process of re-letting the shop and interested parties/ potential tenderers are allowed to suggest possible trades. We will explore other means to handle those not viable or unattractive retail premises.
Photo 8 (para. 4.7)	Need to work out a definite clearance plan for the Chai Wan Factory Estate	The clearance plan for the Chai Wan Factory Estate was announced on 10.3.2011 with evacuation date scheduled for 30.9.2012.

Irregularities Identified	Case Detail	Progress
Case 3 (para. 4.25)	Suspected subletting of factory units at Factory Estate 1	The tenant had updated information of the registered owner under the Business Registration Certificate with the Authority.
Case 4 (para. 4.25)	Suspected subletting of factory units at Factory Estate 2	The tenant had updated information of the registered owner under the Business Registration Certificate with the Authority while the partitions previously erected had been removed.

Our Ref : HD 3-2/M4-35/4/V
Your Ref : CB(4)/PAC/R56

Tel No. : 2761 5341
Fax No. : 2761 7630

Date : 16 May 2011

Clerk to Public Accounts Committee
Legislative Council
8 Jackson Road, Central
Hong Kong
(Attention : Ms Macy NG)

Dear Ms NG,

**The Director of Audit's Report on the
Results of value for money audits (Report No. 56)
Hong Kong Housing Authority :
Management of commercial properties (Chapter 7)**

I refer to your letter of 13 May 2011 on the above subject. Please find attached the following for Members' reference –


- (a) The audited Commercial Operating Accounts of the Hong Kong Housing Authority from 2006/07 to 2009/10 is at **Annex I**. Please note that the 2005/06 Commercial Operating Account cannot be compared directly with those of subsequent years since it included both divested and non-divested properties. As we need some time to break down these accounts according to different management modes in view of the wide range of portfolio of commercial, car parking and non-domestic premises scattered around the territory, we will provide the apportioned accounts for the period from 2006/07 to 2009/10 by end May 2011 ;
- (b) A copy of the Estate Management Branch Circular No. 3/97 to deal with gambling activities in public housing estates, as referred to paragraph 2.13 of the Audit Report, is attached at **Annex II** ;
- (c) A copy of the Estate Management Division Instruction No. ND05/2011 providing new guidelines to step up the unit-to-unit inspection to non-domestic properties according to the risk-based approach, as referred to paragraph 2.21(c) of the Audit Report, is attached at **Annex III** ;
- (d) A breakdown of the numbers and percentages of the 251 vacant retail premises given in Table 3 of paragraph 2.23 of the Audit Report is shown at **Annex IV** ;

/....

Estate Management Sub-division (3)
5/F, Block 2, Housing Authority Headquarters, 33 Fat Kwong Street, Ho Man Tin, Kowloon.

- (e) We would like to highlight that the system to conduct the unit-to-unit inspections to factory estates has been in place for some years. We extended the unit-to-unit inspection system to cover all retail premises in a cycle of 18 months in July 2010. Besides, we have conducted a review of the Factory Estate Operational Manual as referred to paragraph 4.20 of the Audit Report and issued the new version recently. The relevant chapters of the Manual with guidance on patrolling and inspections are at **Annex V** ;
- (f) The Link REIT failed to effect payment of the management fees of estate common areas for a number of public housing estates in July and August 2009. The amount involved was around \$8M. The Link REIT settled all the management fees in arrears in mid-September 2009. This matter was reported to the Legislative Council Panel on Housing at its special meeting on 28 September 2009 ; and
- (g) A breakdown of the 37 major retail facilities listed at Appendix B of the Audit Report into those that are directly managed by the Department and those that are outsourced to property services agents is shown at **Annex VI**.

I would take the opportunity to reiterate that following the Divestment in 2005, Housing Department has been working hard to optimize the use of the residual commercial properties despite the fact that many of them are outdated in design, situated in unpopular location with inferior accessibility, and supported by ageing population in older estates. Through intensified marketing efforts and implementing new measures such as the conversion of surplus retail facilities to other beneficial uses, Housing Department has significantly improved the vacancy rate of overall retail premises from 7.3% to 5% at present. In a similar vein, the vacancy rate for market stalls has drastically fallen from 22% to 9%. We have also significantly boosted the occupancy rate of car parks from 62% to 75% during the corresponding period. For easy reference by Members, we have prepared an additional information sheet on this at **Annex VII**. Notwithstanding the above, we are committed to further improving the use of available commercial properties through various initiatives endorsed by the Commercial Properties Committee.

Yours sincerely,

(LIU King-leung)
for Director of Housing

encl.

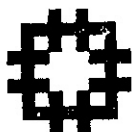
c.c. Secretary for Financial Services and The Treasury (Fax No. : 2147 5239)
Director of Audit (Fax No. : 2583 9063)

Hong Kong Housing Authority
Commercial Operating Account
2006/07 to 2009/10

	Total (2006/07) \$M	Total (2007/08) \$M	Total (2008/09) \$M	Total (2009/10) \$M
Income	1,291	1,273	1,267	1,366
Expenditure	<u>(857)</u>	<u>(743)</u>	<u>(731)</u>	<u>(772)</u>
Operating surplus before exceptional items^(Note 1)	434	530	536	594
Exceptional items ^(Note 2)	<u>(76)</u>	<u>(96)</u>	<u>(225)</u>	<u>(133)</u>
Operating surplus/(deficits) for the year	358 =====	434 =====	311 =====	461 =====

Note 1 : The operational surplus before exceptional items has increased progressively for the past 4 years.

Note 2 : These represent demolition and clearance costs, and expenditure incurred on Government Infrastructure and Community facilities funded by the HA.



HONG KONG HOUSING AUTHORITY

Housing Authority Headquarters, 33, Fat Kwong Street, Kowloon, Hong Kong.

香港房屋委員會

九龍佛光街33號房屋委員會總辦事處

MEMO

From Senior Assistant Director/
Estate Management To HMs/Estates
Our Ref. HD(H)GR 11/28/1 VII Your Ref. _____
Tel. No. 27615009 Date 21 January, 1997 Dated _____
Fax No. 27621110

EMB Circular No. 3/97 **Gambling Activities in states**

Recently, there were a number of reports in the media on gambling activities in public housing estates. We were criticized for not taking positive action in dealing with the matter.

2. It is observed that games which started off as a social gathering of senior citizens living in the estates have developed into concentration of undesirable activities, sometimes with triad involvement.

3. Although the Housing Department is not the proper law enforcement authority to get rid of the illegal gamblers and triad elements, these activities will seriously tarnish our image should we maintain a passive attitude. Estate HMs should, therefore, make a more positive approach to tackle the problem by **reporting at once all suspected gambling activities in domestic and commercial premises and public areas to the Police for appropriate action.** In addition, they should take more noticeable measures to remove the eyesore. The measures include, but not confining to, the following -

- (a) As a start, EAs should be mobilized and formed into small teams to patrol those areas known to the Estate Office with gambling activities. They should take more positive action in stopping these activities and report the case to the Police whenever necessary;
- (b) Organize regular joint abatement action by estate staff and the Police;
- (c) Regularly clear the rendezvous of gambling activities of obstruction articles like chairs, stools, tables, wooden boxes, etc.;
- (d) Promulgate the evil and legal consequences of illegal gambling in estate newsletters;

/....

- (e) Service of Notice-to-quit under Section 19(1)(b) of Housing Ordinance, Cap. 283, to tenants convicted of running gambling activities in domestic and non-domestic premises and to publicize the news widely through estate newsletters and ICRD.


(Simon Li)
Senior Assistant Director/
Estate Management

c.c. DD/HMW
SAD/HA
AD/RM(1)
AD/RM(2)
AD/CSMP
AD/ICR
RCHMs
DSHMs
SHM/MP(E&A)
HM/RM(1)
HM/RM(2)
HM/EM

SL/fm

From : CES/CP	To : All HMs in Estates/DTMOs/ND/CP/ Shopping Centres & PSMs in PSAUs	Date : 08 April 2011
----------------------	--	-----------------------------

**Estate Management Division Instruction No. ND05/2011
Unit-to-Unit Inspection and Daily Patrol
of Commercial Properties**

Status : Mandatory

Contact Point : Mrs. CHAU LEE Tak-yuk HM/CP(3) (Tel.: 2794 5372)
Ms. WONG Lan-nei Nanny AHM/CP(8) (Tel.: 2794 5374)

PURPOSE

1. This instruction promulgates to include storerooms in the unit-to-unit inspection system being carried out by management officers in the Housing Authority (HA)'s commercial properties in the current cycle from 1.7.2010 to 31.12.2011. In addition, a risk-based approach should be adopted in conducting the unit-to-unit inspections, ensuring that high-risk categories are inspected with a higher priority and frequency. The previous EMDI No. ND09/2010 on the same subject is hereby superseded.

BACKGROUND

2. To facilitate the Enhanced Marking Scheme for commercial properties, the unit-to-unit inspection system has been implemented since 1.7.2010 and are being carried out by management officers in the HA's commercial premises in a cycle of 18 months which will end on 31.12.2011. AHMs/HMs/PSMs are required to conduct at least 5% random spot checks by paying visits to the units with inspection already conducted by management officers.
3. In parallel, a standard checklist for daily patrol of the HA's commercial properties by management officers has been devised in order to control the proper use of the HA's properties, fixtures and fittings, including lift-rooms, duct-rooms and storerooms used by the Department etc, as well as to monitor tenants' performance in accordance with the Enhanced Marking Scheme for commercial properties.

RECENT REVIEW

4. Notwithstanding the implementation of the unit-to-unit inspection system since July 2010 and the daily patrol of the HA's commercial properties by management officers, the recent surprise checks have revealed cases of suspected abuse or improper use of retail premises, suspected gambling activities, retail premises not regularly open for business and obstruction problems in the estate common areas. The surprise checks have also detected irregularities such as unauthorized uses and internal alteration in some storerooms currently leased to commercial tenants for storage purpose.

EMDI ND05/2011

5. There is a need for the Department to step up measures in order to combat the problems as mentioned in paragraph 4 above. After conducting a recent review on the management of the HA commercial properties including the day-to-day management of retail premises, we have decided to include storerooms, in addition to shops/shopstalls/cooked food stalls, under the existing unit-to-unit inspection system so that management officers shall carry out visit to each of these premises to verify their internal conditions and detect any breach of tenancy clauses for follow-up actions under the prevailing policies.

REVISED UNIT-TO-UNIT INSPECTION IMPLEMENTATION DETAILS

6. Procedures have been revised to include storerooms under the existing unit-to-unit inspection system. Housing officers of the Department or property officers of PMA/PSA/PSC should carry out visit to each shop/shopstall/cooked food stall/storeroom within the 18-month cycle to verify the internal conditions of these premises, and detect any breach of tenancy/licence clauses for follow-up actions under the prevailing policies. In view that there are only about 9 months left under the first unit-to-unit inspection cycle, storerooms charging other than market rent are exempted from the current unit-to-unit inspections.

Acquisition of the Revised Unit-to-Unit Inspection Form

7. The revised unit-to-unit inspection form at **Annex I** can be obtained and downloaded from e-Housing Portal via *EM > Property Mgt. > Non-Domestic (ND) Mgt. > ND Circulars & Policies > other ND Useful Information*. Management officers should make sufficient copies for use.

Higher Priority and Frequency for High-risk Categories

8. In conducting the unit-to-unit inspections to commercial properties including storerooms, a risk-based approach should be adopted to ensure that those high-risk categories are inspected with a higher priority and frequency. Examples of high-risk categories include gambling activities, unauthorized use and alteration of premises, repeated offenders and retail premises not regularly open for business.
9. For commercial premises including storerooms once suspected to fall into one of the high-risk categories, they should be selected for conducting the unit-to-unit inspections in the first instance. When any irregularity of the high-risk categories is confirmed upon inspection, a systematic warning approach should be adopted for tenancy enforcement actions or in accordance with the Enhanced Marking Scheme (EMDI No. ND18/2006 and EMDI No. ND10/2010 refer) where applicable. The tenants/licensees concerned should be warned through interview, followed by a warning letter of the possible serious consequence if they fail to rectify the observed irregularity. Notice-to-quit (NTQ) should be served to terminate the tenancy/licence if the irregularity persists despite our warnings in two months. For conviction cases such as illegal gambling activities in the HA's commercial premises including storerooms, NTQ can be served without prior warning. A flow chart setting out the procedural guideline on taking enforcement actions against high-risk cases is shown in **Annex II** for easy reference.

EMDI ND05/2011

Monitoring and Reporting Mechanism

10. In case of any observed irregularities during the unit-to-unit inspections or daily patrol, management officers should carry out the investigation immediately, ascertain the reason(s) for non-compliance and take appropriate follow up actions. All inspection forms and the record of appropriate follow up actions taken, if any, should be documented in tenancy files. Irregularities observed in the unit-to-unit inspections and follow up actions taken/to be taken should be reported in the quarterly progress report for submission to DSHMs/SPSMs with a copy to RCMs for monitoring purpose. Cases under the high-risk categories should also be stated in the quarterly progress report for attention of the senior management. A revised sample of the quarterly progress report is attached at **Annex III**.

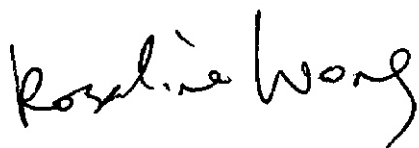
DAILY PATROL

11. It is of crucial importance that public facilities, fixtures and fittings provided in the common areas of shopping centres, markets and cooked food stalls are regularly maintained and kept up to a safe and proper standard. To ensure the proper use and prompt maintenance of HA's properties, fixtures and fittings including lift-rooms, duct-rooms and storerooms used by the Department, and to keep the tenants under control in accordance with the Enhanced Marking Scheme for commercial properties, management officers are required to conduct daily inspections to all the commercial properties within their area of responsibility. To streamline the daily inspection records, a standard form has been devised at **Annex IV** for use by management officers during their daily patrol of HA's commercial properties.
12. To combat obstruction problems in estate common areas, management officers are reminded to step up inspections and daily patrol for taking appropriate enforcement actions against those tenants who have repeatedly committed misdeeds under the Enhanced Marking Scheme and supervising HMs/PSMs should closely monitor the enforcement work. Proper records on the daily patrol at **Annex IV** must be kept and actions on any irregularities/misdeeds detected have to be properly followed up according to the prevailing policies and recorded in tenancy files. Besides, management officers should be conversant with and strictly follow the established procedures under the Enhanced Marking Scheme in taking enforcement actions. After the issue of written warnings or allotment of penalty points, the information system on Marking Scheme in Generic Marking Scheme System (GMSS) under EM Community of e-Housing should be updated simultaneously.
13. The daily patrol form can be obtained and downloaded from e-Housing Portal via *EM > Property Mgt. > Non-Domestic (ND) Mgt. > ND Circulars & Policies > other ND Useful Information*. Management officers should make sufficient copies for use.

EMDI ND05/2011

IMPLEMENTATION

14. This instruction takes immediate effect.



(Miss WONG Lai-ping, Rosaline)
Chief Estate Surveyor / Commercial Properties

Encls.

Annex I - Unit-to-Unit Inspection Form

Annex II - Procedural Guideline on Enforcement Actions against High-risk Cases

Annex III - Quarterly Progress Report on Unit-to-Unit Inspection

Annex IV - Daily Patrol Form

***Note by Clerk, PAC:** *Annexes I, II, III and IV of this Instruction not attached.*

Table 3

**Ageing analysis of vacant retail premises
(31 December 2010)**

Vacant period	Market Stalls	Shopping Centres	Other Places (shops on ground floor and podium)	Total	Percentage
≤1 year	46	19	18	83	33%
>1 year to 2 years	14	2	8	24	9%
>2 years to 3 years	11	3	8	22	9%
>3 years to 4 years	8	3	6	17	7%
>4 years to 5 years	6	1	7	14	6%
>5 years	81	1	9	91	36%
Total	166	29	56	251	100%

Note

- 1: The majority (66%) of the vacant premises are market stalls locating mainly in old estates, such as Kwai Shing West Estate, Wah Fu (II) Estate, Cheung Ching Estate, Pak Tin Estate and Nam Shan Estate.
- 2: Marked improvement as a result of market re-ordering and other leasing measures bringing the overall vacancy rate of market stalls from 22% in 2005 to 9% at present. More market re-ordering programmes are on the pipeline including the projects at Siu Hong Court, Cheung Ching Estate, Lai Yiu Estate and Ping Shek Estate.

<u>Subject</u>	<u>Patrolling and Inspections</u>
<u>Paper No. FH1</u>	<u>Routine/Regular Patrols and Inspections</u>

Reference

Routine/regular patrols and inspection can help to detect irregularities at the earliest opportunity and ensure that –

- (a) the tenants have complied with the terms and conditions of the tenancy agreement or Tenancy Card and Intake Instructions;
- (b) only authorized machines are installed according to the layout plan approved by the management;
- (c) there is no subletting or unauthorized change of trade;
- (d) all building and electrical defects, damaged standard fittings and installations of the factory blocks are readily spotted and immediate repairs and replacement works are carried out;
- (e) there is no unauthorized parking and obstructions within the factory estate boundary;
- (f) all cargo and passenger lifts are in working order;
- (g) all communal areas, toilets and bathrooms are clean and tidy;
- (h) no unauthorized erections or unlawful activities exist in the factory estate including misuse of

estate storerooms/services rooms; and

- (i) there is no illegal hawking within the estate boundary.

2. Patrolling and inspections are important day-to-day work of the HOs, PSA's Property Officers (POs) and the Estate Assistants/Estate Caretaking Guards. Although the latter are engaged mainly on patrolling common area whereas the HOs/POs carry out inspections inside the premises, the HOs/POs have an overall monitoring responsibility in ensuring that all defects and irregularities are made good and rectified. It is therefore imperative that they should work diligently to ensure that daily patrols are properly carried out to cover the whole blocks or areas under their charge.

- End -

Subject Patrolling and Inspections

Paper No. FH2 Special Checks and Inspections

Reference

Thorough Inspections

HOs are required to conduct thorough inspections to every factory unit for the specific purposes of –

- (a) verifying the certified true copy of the application for Business Registration Certificate; (To detect possibility of unauthorized subletting)
- (b) comparing the existing machinery with the approved layout plan; (To detect change of machinery without prior permission)

Intake Inspection

2. As recommended by the ICAC, an inspection should be conducted within the first three months from the date of commencement of a new tenancy.

Tenancy Renewal Inspection

3. A factory inspection should be conducted about six months before the fixed term tenancy is due for renewal.

Unit-to unit Inspection

4. HOs are required to conduct unit-to-unit inspections in a cycle of 18 months on aspects as stipulated in the annual inspection form. In case of any irregularity was detected during inspection, proactive action for intensive investigation should be carried out at once and reported on file for monitoring by the senior.

- End -

Subject Patrolling and Inspections

Paper No. FH3 Inspection Records and Monitoring System

Reference

Having checked and inspected a factory tenancy, the HO/PO should complete a copy of the Factory Undertaking Inspection Form (**Appendix XIV**) which is to be put in file and submitted to AHM at the end of each month together with a copy of the Summary Sheet (HD(F) 56/82) – (**Appendix XV**).

2. At the same time, the HO/PO should maintain a list of all factory units under his/her charge and enter the date of inspection against the appropriate unit number.
3. Upon receipt of the files with completed Factory Undertaking Inspection Forms, the AHM should check them. He should sign and forward the copies of Summary Sheet (HD(F) 56/82) (Revised 2011) to HM for reference and compilation of monthly return while retaining the completed Inspection Forms for selection of one or 5% of the inspected tenancies whichever is more for the purpose of random checking.
4. In case irregularities were discovered and reported in the Inspection Forms, immediate follow-up actions should be taken.
5. To ensure the task is completed on schedule, a quarterly progress report should be submitted to DSHMs for monitoring purpose.

- End -

FACTORY UNDERTAKING INSPECTION FORM

Code Address : _____ Tenant : _____
 Approved Factory
 Name : _____ Tel. No. : _____
 _____ Tenancy
 Approved Trade : _____ Condition : T.C. / T.A. / Fixed

I. Document Checked

a) Business Registration Certificate

Certified true copy of application for B.R.C. to be submitted during first inspection or in case of suspected change of ownership.

	As per certified true copy of application	As per B.R.C. displayed
Cert. No.		
Factory Name		
Business Status		
Name of Applicant		

b) Insurance Policy (if any)

Name of Insurance Co. : _____

Policy No : _____ Insured By : _____

Amount : _____ Insured on : _____ Expiry Date : _____

II. Personnel Checked

a) Tenant(s)

Tenant(s) seen during *inspection / interview

Personal particulars checked during *inspection / interview

b) Operator(s)

Name : _____

Relationship with tenant : _____

c) Caretaker(s)

Name : _____

Relationship with tenant : _____

III. Factory Situation Checked

- a) Factory Name : _____
- b) Trade : _____
- c) Machinery : same as *same as *L/O plan / deviate from L/O Plan
- Remarks : _____
- d) Any irregularities found (e.g. change of trade, unauthorized installation, domestic use, sub-letting, etc.)
- _____

Action Taken :

IV. Remarks

The person(s) *met in the unit / interviewed in the Estate Office has (have) been informed that :

- (i) provision of personal data is voluntary;
- (ii) the personal data collected will be used for tenancy control by the Housing Department; and
- (iii) the data subject(s) has (have) a right of access and correction in respect of the personal data provided. Requests for access to or correction of the personal data may be addressed to the Departmental Data Controlling Officer.

Inspected by :

Name : _____

Post Title : _____

Date : _____

AHM's Comments : _____

Signature : _____

Name : _____

Date : _____

*Delete whichever not appropriate

Summary of Factory Inspection Carried out in the Month of ____/2011
(_____ Factory Estate)

	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
Block No.	No. of Tenancies			Inspection Monthly Quota (C/18)	No. of Inspection Carried Out			No of Tenancies to be inspected (C-G)	Remarks / Reasons if no. of inspection carried out in this Month (F) is less than Monthly Quota (D)
	As at end of Last Month	*Added in this Month	As at end of this Month (A+B)		Completed Cases b/f from Last Month	Inspection conducted in This Month	c/f to Next Month (E+F)		
Grand Total									

* Please indicate the additional number of tenancies created as a result of transfer, new intake, etc.

Major retail facilities (31 December 2010)

Type of facilities	Estate/HOS Court	Year opened	Retail area (m ²)	Management mode ^{Note}
Shopping centre	1. Wah Fu (I) Estate	1967	9,932	HD
	2. Cheung Ching Estate	1977	3,821	PSA
	3. Lai Yiu Estate	1977	1,813	PSA
	4. Nam Shan Estate	1977	4,464	PSA
	5. Wah Fu (II) Estate	1978	4,733	PSA
	6. Cheung Shan Estate	1979	3,554	PSA
	7. Pak Tin Estate	1979	4,464	PSA
	8. Shek Kip Mei Estate	1979	8,876	PSA
	9. Ching Lai Court	1981	535	PSA
	10. Pok Hong Estate	1982	5,345	PSA
	11. Yue Tin Court	1983	873	PSA
	12. On Kay Court	1984	4,228	PSA
	13. Siu Hong Court	1984	4,745	PSA
	14. Lung Poon Court	1987	1,999	PSA
	15. Tin Yan Shopping Centre	2002	3,775	HD
	16. Lei Muk Shue Shopping Centre	2004	7,955	PSA
	17. Hoi Lai Shopping Centre	2005	3,801	HD
	18. Kwai Chung Shopping Centre	2005	7,698	HD
	19. Mei Tin Shopping Centre	2005	3,018	PSA
	20. Shek Pai Wan Shopping Centre	2005	1,338	HD
	21. Ching Ho Shopping Centre	2008	2,370	PSA
	22. Choi Ying Place	2008	1,062	PSA
	23. Tin Ching Shopping Centre	2008	1,407	PSA
	24. Upper Ngau Tau Kok Shopping Centre	2009	1,046	PSA
	25. Choi Tak Shopping Centre	2010	4,174	PSA
	26. Yau Lai Shopping Centre	2010	3,270	PSA
Shops on ground floor or podium	27. Choi Hung Estate	1962	4,467	HD
	28. Ma Tau Wai Estate	1962	1,642	PSA
	29. Fuk Loi Estate	1963	2,449	HD
	30. Ping Shek Estate	1970	5,950	HD
	31. Mei Tung Estate	1974	1,541	HD
	32. Kwai Shing West Estate	1975	5,556	HD
	33. Lai King Estate	1975	5,012	HD
	34. Hing Wah (II) Estate	1976	3,497	HD
	35. Yue Wan Estate	1977	4,509	HD
	36. Fu Shan Estate	1978	4,639	PSA
	37. Chak On Estate	1983	1,939	HD

Note: HD – retail facilities managed by Housing Department (14)
 PSA – retail facilities managed by Property Services Agents (23)

**Vacancy Rates for Retail Premises and Markets
and Occupancy Rate for Carparks**

Vacancy Rate for Retail Premises

3/06	3/07	3/08	3/09	3/10	3/11
7.6%	5.2%	4.2%	5.5%	5.5%	5%

- There has been a significant improvement in the overall vacancy rate of retail premises which has dropped from 7.6% in 2006 to 5% in 2011 through implementing a number of improvement measures.
- Given that some of our retail premises are old aged facilities in unpopular locations with inferior accessibility, there has been a high vacancy rate for individual estates with unattractive retail facilities such as Wah Fu (II), Kwai Shing West and Pak Tin Estates.
- We will intensify our efforts to further reduce the vacancy rate of retail premises by adopting flexible letting terms and tendering procedures, conversion of surplus facilities to other uses and implementing major improvement works for asset enhancement under a 5-year rolling programme for retail premises.

Vacancy Rate for Markets

12/05	12/06	12/07	12/08	12/09	12/10	3/11
22%	21%	20%	14%	11%	10%	9%

- There has been a drastic improvement in the vacancy rate of markets from 22% in 2005 to 9% in 2011 through market re-ordering and conversion to other uses to suit residents' need.
- We will continue conducting market re-ordering exercises and will adopt a tailor-made approach of initiatives to address the high vacancy problem for a few markets located in Wah Fu (II) and Kwai Shing West Estates.

Occupancy Rate for Carparks

3/06	3/07	3/08	3/09	3/10	3/11
62%	64%	68%	70%	73%	75%

- There has been a substantial improvement in the occupancy rate for carparks from 62% in 2006 to 75% in 2011 through conversion of surplus carparking spaces to motorcycle parking spaces and to other uses, such as welfare and community uses.
- We will continue our efforts to further improve the utilization of parking spaces by implementing major improvement works and conversion into other uses under a 5-year rolling programme for carparks. On-going improvement projects include the conversion of Nam Shan Car Park and Shek Pai Wan Car Park into classrooms for a University and welfare premises respectively.

Our Ref : HD 3-2/M4-35/4/V
Your Ref : CB(4)/PAC/R56

Tel No. : 2761 5341
Fax No. : 2761 7630

Date : 30 May 2011

Clerk to Public Accounts Committee
Legislative Council
8 Jackson Road, Central
Hong Kong
(Attention : Ms Macy NG)

Dear Ms NG,

**The Director of Audit's Report on the
Results of value for money audits (Report No. 56)
Hong Kong Housing Authority :
Management of commercial properties (Chapter 7)**

Further to our reply of 16 May 2011 on the above subject, the apportioned commercial operating accounts for the period from 2006/07 to 2009/10 as mentioned in paragraph 1(a) is attached.

Yours sincerely,


(LIU King-leung)

for Director of Housing

encl.

c.c. Secretary for Financial Services and The Treasury (Fax No. : 2147 5239)
Director of Audit (Fax No. : 2583 9063)

Estate Management Sub-division (3)
5/F, Block 2, Housing Authority Headquarters, 33 Fat Kwong Street, Ho Man Tin, Kowloon.

Annex I

Hong Kong Housing Authority Commercial Operating Account 2006/07 to 2009/10 (Apportioned by Management Mode)

	Total (2006/07) \$M		Total (2007/08) \$M		Total (2008/09) \$M		Total (2009/10) \$M	
Management Mode ^(Note 1)	HD	PSA	HD	PSA	HD	PSA	HD	PSA
Income								
(i) Retail premises	308	283	311	269	293	267	307	315
(ii) Car park	14	153	14	161	13	183	6	193
(iii) Factory estate	58	62	56	60	50	57	54	64
(iv) Welfare premises	141	272	133	269	127	277	136	291
Sub-total	521	770	514	759	483	784	503	863
Total	1,291		1,273		1,267		1,366	
Expenditure								
(i) Retail premises	(166)	(204)	(146)	(167)	(127)	(169)	(140)	(175)
(ii) Car park	(7)	(140)	(7)	(140)	(23)	(143)	(6)	(154)
(iii) Factory estate	(66)	(55)	(47)	(49)	(47)	(46)	(48)	(48)
(iv) Welfare premises	(62)	(157)	(43)	(144)	(34)	(142)	(40)	(161)
Sub-total	(301)	(556)	(243)	(500)	(231)	(500)	(234)	(538)
Total	(857)		(743)		(731)		(772)	
Operating surplus before exceptional items ^(Note 2)								
(i) Retail premises	142	79	165	102	166	98	167	140
(ii) Car park	7	13	7	21	(10)	40	-	39
(iii) Factory estate	(8)	7	9	11	3	11	6	16
(iv) Welfare premises	79	115	90	125	93	135	96	130
Sub-total	220	214	271	259	252	284	269	325
Total	434		530		536		594	
Exceptional items ^(Note 3)	(76)		(96)		(225)		(133)	
Operating surplus/(deficits) for the year	358 =====		434 =====		311 =====		461 =====	

Note 1 : HD – managed by Housing Department
PSA – managed by Property Services Agents

Note 2 : The operational surplus before exceptional items has increased progressively for the past 4 years.

Note 3 : These represent demolition and clearance costs, and expenditure incurred on Government Infrastructure and Community facilities funded by the HA.



Our Ref : HD 3-2/M4-35/4/V
Your Ref : CB(4)/PAC/R56

Tel No. : 2761 5341
Fax No. : 2761 7630

Date : 31 May 2011

Clerk to Public Accounts Committee
Legislative Council
8 Jackson Road, Central
Hong Kong
(Attention : Ms Macy NG)

Dear Ms NG,

**The Director of Audit's Report on the
Results of value for money audits (Report No. 56)**

**Hong Kong Housing Authority :
Management of commercial properties (Chapter 7)**

I refer to your letter of 27 May 2011 on the above subject.

Members of the Commercial Properties Committee (CPC) noted the continued demand for the 8,000 small factory units in the six newer factory estates of the Housing Authority at the meeting held on 28 April 2011. In view of their high letting rate, over 99%, CPC Members supported the Housing Department's proposal to continue managing them *pro tem* and to review the situation from time to time. This modification to the policy was set out in paragraph 16 of the attached Paper No. CPC 17/2011. We will inform the Legislative Council if there is a substantial change to the long-term policy on the ownership and management of these factory estates in future.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Liu King-leung'.

(LIU King-leung)

for Director of Housing

encl.

c.c. Secretary for Financial Services and The Treasury (Fax No. : 2147 5239)
Director of Audit (Fax No. : 2583 9063)

Estate Management Sub-division (3)
5/F, Block 2, Housing Authority Headquarters, 33 Fat Kwong Street, Ho Man Tin, Kowloon.

**Memorandum for the Commercial Properties Committee of
the Hong Kong Housing Authority**

Audit Report on Management of Commercial Properties

PURPOSE

To inform Members of the major findings, recommendations and the management response to the Value for Money (VFM) Audit Report conducted by the Audit Commission (AC) on the Hong Kong Housing Authority (HA) : Management of Commercial Properties.

BACKGROUND

2. VFM study aimed at identifying areas for improvement in terms of internal control, operational efficiency, economy and effectiveness in management of HA's non-domestic properties. It comprehensively covered the management and letting of commercial properties including retail premises, car parks and factory estates, performance measurement and reporting mechanism as well as a concluding chapter for the 2005 divestment exercise. Details of VFM study are contained in Chapter 7 of Report No. 56 of the Director of Audit which is available on website at <http://www.aud.gov.hk>. A Summary of the relevant Audit Report is at the **Annex**. The Public Accounts Committee of the Legislative Council will conduct hearing on this Chapter in mid-May 2011.

MAJOR FINDINGS AND MANAGEMENT RESPONSES

3. AC recognised that HA and the Housing Department (HD) have taken various measures to optimise the effective use of commercial properties. However, individual cases on management irregularities such as subletting, gambling activities, unauthorised use of premises and obstructions in estate public areas were observed in the course of auditing. Recommendations were made for enhancing the effectiveness in management of HA's non-domestic properties in these respective areas.

4. We welcome and generally agree with the views and comments made by AC. Most of the recommendations have either been implemented or will be taken on board. Where policy clearance is required, we will seek the views from HA or this Committee. As to the major findings and recommendations, the management has the following responses—

(a) Management of Retail Premises

5. While acknowledging that HD had reduced the vacancy rate by introducing a number of initiatives in the past few years, AC recommended HD to (i) enhance actions in publicising and re-letting vacant premises; (ii) re-generate strategy for market re-ordering and shopping centre improvement works; (iii) speed up the implementation of revised leasing strategy for cooked-food-stalls; and (iv) intensify control on operating expenditure.

Day-to-day management of retail premises

6. The management has investigated into individual suspected cases of improper use of retail premises and storerooms and taken tenancy enforcement actions including issuance of notice to quit under Section 19 (1)(b) of the Housing Ordinance to the tenants/licensees identified in the report. HD will report promptly all suspected gambling activities to the Police for enforcement action and continue to step up measures against improper use of retail premises and gambling activities. We will also continue to combat obstructions in estate public areas under the Enhanced Marking Scheme.

7. We have issued detailed guidelines to advise HD/contractor staff to step up unit-to-unit inspections, in particular those non-trading retail premises and repeated offenders. Irregularities observed during the inspections and subsequent follow-up actions will be monitored by the senior management on a quarterly basis.

8. The management is studying the feasibility of specifying the opening hours of shop premises in the tenancy agreements according to the nature of business and customers' demand and will obtain policy blessing from this Committee as and when required.

Letting of retail premises

9. HD will continue to publicise vacant premises for re-letting as frequently as practicable. For premises with limited retail potential, we will consider implementing conversion plan in the longer term.

Monitoring of operating expenditure

10. HD will monitor operating expenditure of the retail facilities against the benchmarks, of which periodical reviews will be conducted.

(b) Management of Carparks

11. AC appreciated HD's efforts in converting surplus carparks for other uses and recommended us to regularly review the parking planning standards and expedite the conversion of excessive carparking facilities for better utilisation of resources.

Planning the provision of carparking facilities

12. HD will maintain the existing co-ordination mechanism with the Transport Department to review and refine the planning standards of parking spaces and will carefully plan the provision of carparking facilities to new public housing developments on a case-by-case basis.

Converting surplus carparking facilities into other uses

13. The project quoted by AC was a very special case, of which HD had exercised flexibility to speed up the establishment of a converted premises to strengthen the community cohesiveness, create job opportunities and provide training for volunteers in a new town.

14. HD will continue the practice of making rental assessment for major conversion projects with due consideration on the conversion costs and the proposed use of converted premises.

(c) Management of Factory Estates

15. AC recommended HA to formulate a clearance plan for Chai Wan Factory Estate early and to develop a strategy for the long-term development of the six newer factory estates.

16. Upon approval by this Committee, we announced the clearance of Chai Wan Factory Estate on 10 March 2011 with tentative evacuation date scheduled for 30 September 2012. HD will continue to manage the six newer factory estates, viz Wang Cheong, Yip On, Hoi Tai, Sui Fai, Chun Shing and Kwai On and review the situation from time to time.

17. Regarding the day-to-day management of factory estates, HD has investigated into individual suspected subletting cases and taken necessary actions to rectify the irregularities. We have also conducted a review of the operating procedures and will strengthen enforcement actions against subletting and improper use of the factory units.

(d) Performance Measurement and Reporting

18. AC considered a need to revise the calculation methodology of vacancy rate for retail premises. In response, HD has excluded all new premises not yet ready for letting from the total retail stock in calculating the overall vacancy rate. HD will also revisit the approach in reporting vacancy rate of different categories of non-domestic premises and consider setting specific performance indicators and targets for different types of commercial properties where appropriate.

19. To tap the feedback from customers for continued improvement, HD will extend the scope of the annual Public Housing Recurrent Survey to cover residents' satisfaction level on the management of HA's commercial properties from 2011 onwards.

(e) 2005 Divestment Exercise

20. AC noted the complexity and complication of works involved in the 2005 divestment exercise. In planning a similar exercise in future, AC recommended the Administration to critically assess the potential financial implications of transferring the beneficial ownership of the divested properties without a definite timeline for the transfer of legal titles.

21. At the time of divestment in November 2005, HA had fully received the purchase price and there was no loss of revenue to HA. The original target date of mid-2008 to complete the transfer of legal titles was re-scheduled to July 2010 in view of the unforeseen statutory requirements and complexities encountered in the lease procurement process. HA met the revised timeframe for the whole procurement task in July 2010.

22. AC also recommended the Administration to conduct a post-implementation review (PIR) of the divestment exercise. Although HA has no plan to further divest its retail and carparking facilities, we will conduct a PIR of the 2005 exercise at an appropriate time.

IMPLEMENTATION

23. HD has been working closely with the relevant parties to implement all the agreed recommendations. The management will conduct follow-up review to further examine the implementation progress.

PUBLIC REACTION

24. The public would welcome our measures for enhancing the management of HA's non-domestic properties.

INFORMATION

25. This paper is issued for Members' information. A briefing to Members will be made at the forthcoming meeting of the Commercial Properties Committee to be held on 28 April 2011.

Miss Michelle LAU
Secretary, Commercial Properties Committee
Tel. No. 2761 7928
Fax No. 2761 0019

File Ref. : HD 3-2/M4 – 35/4
(Estate Management Division)
Date of Issue : 20 April 2011

Report No. 56 of the Director of Audit — Chapter 7

HONG KONG HOUSING AUTHORITY: MANAGEMENT OF COMMERCIAL PROPERTIES

Summary

1. The Hong Kong Housing Authority (HA) is a statutory body established under the Housing Ordinance (Cap. 283), with the Housing Department (HD) acting as its executive arm. In November 2005, HA divested 180 retail and carpark (RC) facilities to a Real Estate Investment Trust (REIT) which was listed on the Stock Exchange of Hong Kong. Following the divestment, HA has continued to manage the non-divested commercial properties and those provided under new public housing developments.

2. As at December 2010, the commercial and non-domestic properties under HA's management comprised 168 600 square metres of retail areas and 27 000 carparking spaces, as well as factory, welfare and other miscellaneous premises. In 2009-10, HA commercial operations generated an operating surplus of \$461 million. HA's Commercial Properties Committee (CPC) advises HA on policies concerning its commercial, industrial and other non-domestic facilities, and optimising the financial return on its investment. The Audit Commission (Audit) has recently conducted a review of the management of HA commercial properties.

Management of retail premises

3. *Day-to-day management of retail premises.* Audit visited 12 HA major retail facilities between October 2010 and January 2011 and found that: (a) some storerooms had been altered by tenants for other uses without HD's approval; (b) suspected gambling activities appeared prevalent in some retail facilities; (c) some let-out retail premises were not open for business (i.e. non-trading) during normal business hours; and (d) there were areas where improvements could be made in the implementation of the HA marking scheme. *Audit has recommended that the Director of Housing should: (a) request HD staff and contractors to step up their daily patrol work and unit-to-unit inspections to prevent unauthorised use and alteration of retail premises (including storerooms); (b) step up measures to combat suspected gambling activities in HA retail facilities; (c) ascertain the reasons for the prevalence of non-trading in some retail facilities and take actions to address them; and (d) remind HD staff and contractors to strictly follow the established procedures in enforcing HA marking scheme.*

4. ***Letting of retail premises.*** Although many HA retail premises have remained vacant for a long time, HD did not take adequate measures to ensure that these premises were widely publicised and put up for open tender as frequently as practicable. For a vacant premises which did not attract any bidder in an open tender, HD would normally take about two calendar months to re-tender the same premises. Also, HD staff may not have full market information when re-designating the trade appropriate for the premises in the re-tendering exercise. *Audit has recommended that the Director of Housing should: (a) ensure that all vacant retail premises available for letting are widely publicised; and (b) in re-letting vacant retail premises, further encourage prospective tenants to make trade suggestions.*

5. ***Implementation of improvement measures.*** In recent years, HA has implemented a number of improvement measures for its retail premises, such as earmarking four retail facilities for early consideration of major improvement works and conducting “re-ordering” exercises in a number of markets. In setting the priority for major improvement works, HD mainly took into account the commercial potential of the retail facilities concerned. Audit also noted that although HD had taken improvement measures in some markets, their vacancy rates remained high. *Audit has recommended that the Director of Housing should: (a) duly take into account the vacancy rates of retail facilities when selecting them for major improvement works to enhance their commercial potential; and (b) take early actions to address the long-standing vacancy problem in some HA markets.*

6. ***Monitoring of operating expenditure.*** To ensure that retail facilities are operated cost-effectively, HD has set major operating expenditure benchmarks for compliance by its estate housing managers. In 2009-10, many retail facilities had their operating expenditure exceeding HD benchmarks. Some estate housing managers had not fully reported the non-compliance to the senior management, nor had they proposed adequate follow-up action for improving the situation. *Audit has recommended that the Director of Housing should improve the current monitoring mechanism to ensure that effective follow-up actions are taken on all cases of non-compliance.*

Management of car parks

7. ***Planning the provision of parking facilities.*** Prior to 2009, parking facilities for public housing developments were built according to old planning standards stipulated in the Hong Kong Planning Standards and Guidelines (HKPSG). According to HD records, for many aged estates, the provision of public housing carpark facilities had turned out to be greater than the actual demand, leading to high vacancy rates in many HA car parks. Since 2009, substantial revisions to the parking standards have been made to HKPSG.

Audit has recommended that the Director of Housing should, in consultation with the Transport Department, continue to regularly review the parking planning standards, having regard to the changing supply and demand conditions.

8. ***Measures to improve the utilisation of parking spaces.*** In recent years, HD has taken various measures to improve the utilisation of parking spaces, including conversion of surplus carpark facilities into other beneficial uses and letting of parking spaces to non-residents. In 2010, HD conducted strength-weakness-opportunity-threat (SWOT) analysis of 38 car parks (with occupancy rate below 70% and with more than 20 parking spaces) and categorised them into different groups for follow-up actions. *Given that many of the 38 car parks had a consistently low occupancy rate for many years, Audit has recommended that the Director of Housing should expedite efforts to implement the recommendations arising from the SWOT analysis.*

9. ***Conversion of surplus carpark facilities into other uses.*** Since 2006, HD has converted some underutilised parking facilities into other uses. As at January 2011, four projects were completed and successfully leased out. One of these projects related to leasing part of a car park to an organisation. Although this project was a commercial letting according to HD records, the rent charged to the organisation was on a par with the concessionary rent normally applicable for welfare lettings. This was contrary to HD's established practice of charging market rate for commercial lettings. *Audit has recommended that, in exploring major conversion of commercial premises in future, the Director of Housing should ensure that the rent for the converted premises is assessed, duly taking into account the conversion costs and the proposed use of the premises.*

Management of factory estates

10. Having regard to its core mission of providing subsidised rental housing, HA decided in 1989 to progressively absolve itself from the ownership and management of factory estates in the long term. Since then, a number of factory estates had been cleared. As at January 2011, the HA still managed seven factory estates. Of these, the Chai Wan Factory Estate (CWFE) was built in 1959 using old design standards without lift service. The remaining six, completed in or after 1979, were built to comparatively modern standards.

11. ***Clearance of old factory estates.*** In November 2000, HA reviewed the position of the old factory estates (those built in the late 1950s to mid-1970s). Given the obsolete design and increasing maintenance costs, HA noted that the estates were approaching the point where clearance needed to be considered. Up to January 2011, HA had cleared all old factory estates, except

CWFE. CWFE had been running at a deficit of about \$2 million each year and was in poor building conditions. Audit raised concern about a lack of a definite clearance plan for CWFE. In the event, CPC approved in March 2011 a clearance plan for CWFE.

12. ***Long-term development of newer factory estates.*** Since 1989, it has been HA's policy to absolve itself from the ownership and management of factory estates (see para. 10). However, up to January 2011 (after more than 21 years), HD had not formulated a long-term strategy to implement the policy. *Audit has recommended that the Director of Housing should review the position of the six newer factory estates and develop a strategy for their long-term development.*

13. ***Subletting of factory premises.*** Under the provisions of factory tenancy agreement, a tenant should not sublet factory premises without HD written permission. To help detect subletting or unauthorised use of factory premises, HD has laid down procedures to be followed by its staff. These procedures include conducting thorough inspection of each factory unit on a 18-month cycle covering the checking of any change of factory name and trade, and whether the factory is operated by the tenant or by an unauthorised person. Audit visited two factory estates and examined their inspection records. Audit found that HD procedures had not been properly followed.

14. Audit also found that many factory units bore names or carried out trades which were different from those shown in HD records. Audit selected some factory units for conducting business registration search. The results indicated that, for some of these units, the tenants were not the business owners. Instead, businesses were operated by third parties. *Audit has recommended that the Director of Housing should follow up on the suspected subletting cases identified by Audit and step up efforts to combat the problem of subletting.*

Performance measurement and reporting

15. HA has set various key performance indicators (KPIs) and targets for the management of commercial properties. KPIs include vacancy rate for retail premises, rent arrears, and operating expenditure as a percentage of income. Audit found that: (a) HD had not properly calculated the vacancy rates of retail premises for reporting to CPC; (b) HD did not systematically collect feedback on the residents' satisfaction level on various aspects of performance in the management of commercial properties; and (c) apart from retail premises, there were no KPIs/targets to measure the vacancy position of other types of properties. *Audit has recommended that the Director of Housing should: (a) review and revise the basis for calculating the vacancy rate of retail premises; (b) devise a mechanism to gauge, and report to CPC, the residents' satisfaction*

level concerning management of commercial properties; and (c) consider setting specific KPIs and targets for different types of commercial properties.

The way forward

16. The divestment of 180 RC facilities in 2005 (see para. 1) was the first exercise of its kind implemented by HA. In 2006, the Administration reported that HA would look for opportunities to further divest the remaining RC facilities and those to be built in the future. In December 2009, the Secretary for Transport and Housing said that HA still had no plan to further divest its properties. There have been various issues arising from the 2005 divestment exercise, including the transfer of legal titles of divested properties from HA to REIT. *Audit has recommended that the Director of Housing, in consultation with the Secretary for Transport and Housing and the Secretary for Financial Services and the Treasury, should: (a) conduct a post-implementation review of the 2005 divestment exercise to evaluate its effectiveness and to identify if there are lessons to be learnt; and (b) based on the outcome of the review, map out the way forward for the management of HA commercial properties.*

Response from the Administration

17. The Director of Housing agrees with the audit recommendations.

April 2011

Our Ref : HDCR4-2/PS/4-35/2
Your Ref : CB(4)/PAC/R56

Tel No. : 2761 5049
Fax No : 2761 7445

24 May 2011

Clerk to Public Accounts Committee
Legislative Council
8 Jackson Road, Central
Hong Kong
(Attention : Ms Macy NG)

Dear Ms Ng,

**The Director of Audit's Report on the
results of value for money audits (Report No. 56)**

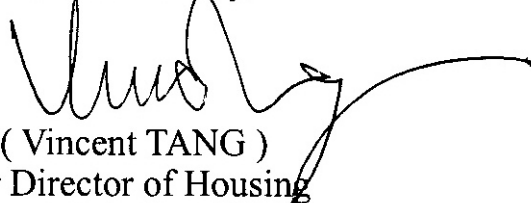
**Hong Kong Housing Authority:
Management of commercial properties (Chapter 7)**

I refer to your respective letters of 17 and 18 May 2011 on the captioned matters. I hereby provide the information as requested detailed in the two aforementioned letters as follows –

- (a) The Hong Kong Housing Authority's standard tenancy agreements for shops and for food premises/restaurants respectively; and
- (b) information provided by the Administration in response to the Clerk to the Public Accounts Committee's letter of 17 May 2011.

Our reply in Chinese will follow shortly.

Yours sincerely,



(Vincent TANG)
for Director of Housing

C.C.

Secretary for Financial Services and the Treasury (Fax No.: 2147 5239)

Director of Audit (Fax No.: 2583 9063)

***Note by Clerk, PAC:** *The Hong Kong Housing Authority's standard tenancy agreements for shops and for food premises/restaurants not attached.*

The Public Accounts Committee

Information provided by the Administration in response to the Clerk to the Public Accounts Committee's letter of 17 May 2011

We note that the reference to “notional” Government rent chargeable cited by the Director of Audit in his report covers the period from 1 July 2008 up to 14 July 2010, whereas questions (a) to (c) below relate to the time before this relevant period. We have nevertheless set out as far as possible information in response to questions (a) to (c) for the Public Accounts Committee's reference. We have also set out in the following paragraphs our response to the remaining questions.

(a) when the then Secretary for Housing, Planning and Lands (“SHPL”) attended the Executive Council (“ExCo”) meeting during which the ExCo made the decision of transferring the beneficial ownership for the remaining 104 properties to The Link REIT without a definite timeline for the transfer of legal titles, which Government official had provided advice to the SHPL and what advice had been given. Please provide the Committee with a copy of the relevant brief for the SHPL for attending the ExCo meeting;

2. At the meeting of the Executive Council (ExCo) held on 15 July 2003, the Chief Executive (CE) in Council considered the Administration's proposal pertaining to the divestment of Hong Kong Housing Authority (HA)'s Retail and Car-parking (RC) Facilities and ordered that HA's agreement in principle be sought to divest its RC facilities. Details were reported and set out in the Legislative Council (LegCo) Brief on “Divestment of HA's RC facilities” issued to the LegCo in July 2003 [LegCo Brief File Ref HD(CR)/(CS)Div/DV/3] (copy is at **Enclosure A**). According to the LegCo brief, the issue on land lease and Government rent (paragraphs 13 to 14) were specifically addressed. ExCo was aware of the fact that new leases of land are normally granted subject to payment of Government rent, and that after the Government leases are granted, The Link Real Estate Investment Trust (The Link REIT) will need to pay Government rent in respect of the RC facilities.

Enclosure A

3. For the said ExCo meeting, the then Secretary for Housing, Planning and Lands (SHPL) attended as an official member of ExCo. In general, senior Government officials attending ExCo for the discussion item under their purview may receive briefs, should they find it necessary and appropriate, prepared by subject officers in the concerned policy bureaux and departments. However, in this case, we have carried out a search through the relevant subject files available in our office but cannot source or locate any briefing materials prepared for the then SHPL for his attendance at the said ExCo meeting.

(b) a copy of the engagement letter for the legal adviser engaged by the Administration for the divestment exercise, if any; and

(c) whether the legal adviser engaged by the Administration had assessed and advised the Administration on the risks and potential financial implications of the delay in transfer of legal titles of the divested properties; if the legal adviser had, what were the Administration's considerations and ways to address the risks (please also provide a copy the relevant legal advice to the Committee); if the legal adviser had not, whether the Administration would consider seeking remedy from the legal adviser for failing to provide such advice and protect its interests;

4. For the divestment exercise, the Hong Kong Housing Authority sought external legal advice but, as far as we can determine, the policy bureaux and Government departments involved, relied upon the Government's own internal legal advisors for matters relevant to their particular interest.

5. As pointed out in our response to question (d) below, and as reflected in the LegCo brief, ExCo acknowledged that the Link would only be charged Government rent once the leases were completed.

(d) whether the overall valuation of the divested properties had reflected the financial implications of a possible delay in charging Government rent arising from the late completion of the process of transfer of legal titles; if it had, please provide the Committee with information on the valuation and highlight the relevant parts;

6. New leases of land are normally granted subject to payment of Government rent. After the leases are granted and the legal titles to the RC properties are transferred to The Link REIT, The Link REIT will need to pay Government rent in respect of such RC properties. This was clearly explained in paragraph 14 of the LegCo Brief on “Divestment of HA’s RC facilities” issued to the LegCo in July 2003 as attached at **Enclosure A**.

7. The valuation of the RC properties covered was clearly intended to ensure that a fair market price was set for all of the properties in question. This was clearly explained in Annex A to the LegCo Brief. Separately, it is clear from the ‘Manager’s Discussion and Analysis of Future Operations’ section of the Offer Circular that The Link REIT would be required to pay Government rent for List 1 properties upon divestment and that at a later stage for List 2 properties upon the issue of Government leases and the legal titles to the RC properties be transferred to The Link REIT. This shows that this was a factor fully taken into account in the divestment exercise. Indeed, the fact that the leases would be put in place over a number of years following divestment was also stated in the documents. In particular, the fact that the intention was originally to complete this exercise in 2008 was clearly set out on page 93 of the Offer Circular (an extract from the said Offer Circular is at **Enclosure B**).

Enclosure B

(e) whether the Administration had negotiated with The Link REIT for compensating the Government for not being able to charge the Government rent due to the late completion of the process of transfer; if it had not, whether it would consider doing so; and

8. Given the fact that the obligation to pay the Government rent

only arises when the Government lease concerned is granted, The Link REIT is not obliged to pay the Government rent for those properties with no Government leases and the legal title to the properties yet to be transferred to The Link REIT. There is thus no legal basis for the Government to recover from The Link REIT the alleged “notional” Government rent chargeable in respect of the properties for the period during which the Government leases were yet to be granted.

(f) the reasons for the late completion of the transfer of legal titles of each of the 54 divested properties mentioned in paragraph 6.13 of the Audit Report.

Enclosure C 9. Our responses are set out in **Enclosure C**.

Housing Department
23 May 2011

***Note by Clerk, PAC:** *Enclosures A and B not attached.*

Legislative Council
Public Accounts Committee
Transfer of Legal Titles for the Divested Properties

PURPOSE

This paper provides background to and information on the need to revise the target date for completion of the transfer of legal title for the divested properties.

BACKGROUND

2. The land on which most of the public housing estates are situated, including retail and carparking facilities within the estates, is vested in the Hong Kong Housing Authority (HA) by the Government under a vesting order. To complete the transfer of legal title of the divested properties to The Link Real Estate Investment Trust (The Link REIT), it would first be necessary for the HA to obtain land leases from the Government and to enter into relevant deeds of mutual covenant (DMCs) for those properties. Owing to the large number of properties under the divestment portfolio, when The Link REIT was listed in November 2005, it was only possible to transfer to The Link REIT both the legal titles and beneficial ownership for 76 out of the 180 properties sold to The Link REIT. For the remaining 104 properties, only beneficial ownership was transferred at that time. Accordingly, agreements were entered into between the Government and the HA (Government Agreement), and between the HA and The Link Properties Limited (PropCo) (Property Agreement) to provide for, inter alia, the transfer of legal title to the remaining properties to The Link REIT subsequent to its listing.

3. In the Offering Circular, there is a statement of intention indicating that ‘it is intended that the process (for transfer of legal title to the remaining properties) will be completed by the middle of 2008.’ The material terms of the Government Annex A Agreement and the Property Agreement are summarized at pages 192 to 196 of the Offering Circular, and it is stated at page 192 of the Offering Circular that these agreements pertaining to the acquisition of properties are available for physical Annex B inspection at the office of Linklaters. Also, at page 45 of the Offering Circular, it is stated that there is no exact timeline for transferring the legal title to the remaining

properties, and there is no specified recourse against the Government in the event it fails to comply in a timely manner with the Government Agreement.

REASONS FOR NOT MEETING THE ORIGINAL TARGET DATE

4. The procurement of leases and DMCs after the sale of beneficial interest of the divested properties is an unprecedented task. The work involved in the procurement process was much more complex and onerous than could be anticipated at the time of planning and of divestment. During the procurement process, new requirements and restrictions were imposed by various Government departments. There was also a host of other unforeseen issues seriously affecting the progress. In the light of these circumstances, it was thus necessary to revisit and revise the original target completion date for the transfer of legal titles. The details are set out in the following paragraphs.

Certification of Gross Floor Area (GFA) under Lease

5. New procedures and requirements on certification of GFA under lease were introduced by the Lands Department (LandsD) in end 2005, shortly after the listing. Pending finalization and issue of the new procedures and requirements by the LandsD, progress of the programme was seriously affected until end 2006. Moreover, these changes resulted in considerably longer processing time for individual leases, which in turn significantly affected the overall programme.

Planning Issues

6. New planning requirements regarding carving out of free standing Government, Institution and Community (GIC) facilities from lease boundaries and building height restrictions ^{Note 1} were raised by Planning Department (PlanD) in early 2007. The Housing Department (HD) made repeated representations to PlanD for not applying the new planning requirements to the remaining properties, in particular in relation to those leases of which approval in principle had already been granted by LandsD. However, PlanD considered that no exceptions could be

^{Note 1} Building height restrictions stipulate the maximum building height of a development upon redevelopment, and aims to address the rising public concern on excessive building heights and bulk of new developments.

allowed. Significant additional liaison work was thus required with relevant Government departments on the determination of the revised boundary and on granting of appropriate rights and easements, including for those leases on which approval in principle had been granted by LandsD. More specifically, the imposition of building height restrictions entailed a revision of the Master Lease document ^{Note 2}, and additional efforts in taking de-facto measurements on-site for determining the building heights for stipulation in the respective leases, in preparing the roof-top structures list, and in finalizing the relevant legal documentation. The lease finalization work was inevitably deferred as a result. Subsequent preparatory works for DMC and title transfer were also seriously affected.

DMC Issues

7. The assignment programme had been further affected by revisions to the Model DMC ^{Note 3} required by the Legal Advisory and Conveyancing Office (LACO) of LandsD to align with the new DMC requirements. There were also changes necessitated by the legislative amendments then introduced.

8. Promulgated in April 2006, LACO Circular Memorandum No. 56 (LACO CM56) set out various new guidelines for drafting of DMC with a view to incorporating the Government's initiative on building safety. In view of the scope and complexity of the new requirements, HD appointed a legal consultant in May 2006 to revise the then Model DMC for complying with the new guidelines. As substantial revisions were involved, it had taken over six months for the legal consultant to complete the work and to secure the final approval from LACO. During the period, repeated requests were made to LACO for granting waiver to HA, in particular in relation to the new guideline No. 36 which set out a new requirement for submitting a maintenance manual ^{Note 4} for major works and installations (for both divested and HA retained portion) within one month of the date of the DMC.

^{Note 2} Master Lease for divested properties was the form of Government lease as approved by the Government for the public rental housing (PRH) estates with divested properties. Individual leases were prepared based on the Master Lease, with necessary modifications to suit the particular circumstances of each estate.

^{Note 3} Model DMC was the form of deed of mutual covenant approved by the Government for the PRH estates with divested properties. The Model DMC only served as a general framework based on which individual DMCs were prepared with necessary modifications to suit the particular circumstances of each property.

^{Note 4} Under the new guideline, a developer must compile for the reference of the owners a maintenance manual for all the major works and installations in the development. The maintenance manual must include all as-built record plans of the building and services installations, all warranties and guarantees provided by the contractors, recommended maintenance strategy and procedures, and checklist for routine maintenance inspection etc.

However, after lengthy negotiations, LACO decided that no exemption could be granted to the HA, but agreed to allow extension of time for deposit of the maintenance manual.

9. Further revision of the Model DMC was necessitated by the enactment of the Building Management (Amendment) Ordinance on 1 August 2007. The HD engaged a legal consultant in September 2007 to review the Model DMC to ensure its consistency with the new requirements under the statute. All the remaining DMC cases had to be premised on the revised model and had to be re-submitted to LandsD for approval. This further lengthened the title transfer programme.

Other Complications

10. The situation was further aggravated by unexpected complications which arose from time to time during the processing of individual leases, for example,

- Presence of structures with historical values within the site.
- Requirement to demolish structures or transplant trees erected over the Drainage Reserve Area.
- Requirement to protect highway structures and to build in appropriate lease clauses.
- Reservation of land stratum for new railway lines to pass through.
- Inclusion of slopes within lot boundaries for maintenance.
- Resolution of projecting structures from the lot over Government land or private lot.
- Resolution of encroachment over adjoining lot or vice versa.

11. Such complications required additional negotiations with relevant Government departments and parties, re-submission to LandsD for approval and/or preparation of complex legal documentation.

ACTIONS TAKEN BY HA

12. The issues as set out in paragraphs 5 to 9 were raised by various Government departments, and inevitably would take time to resolve to the satisfaction of all departments concerned. As set out in the paragraphs above, the

new requirements introduced then were put in place to address various public concerns and for the sake of protecting the overall interests of the parties concerned. In the light of these circumstances which could not be anticipated at the time of planning and of divestment, the HA had taken every possible measure to overcome these difficulties and expedite the procurement task, including engagement of temporary staff on HA contract terms for secondment to the Government Property Agency and LandsD to work on the lease and DMC procurement project, frequent liaison and day to day telephone contacts were carried out with the Government departments and parties concerned to resolve the outstanding problems as soon as possible.

13. Based on the then new requirements and special circumstances as set out in paragraphs 5 to 10, and in the light of experience gained in working with the Government departments and parties concerned to resolve the relevant issues, the HA considered that realistically, the completion of the whole procurement exercise could only be by July 2010. In its report to the Legislative Council (LegCo) Panel on Housing in March 2008 and to the Establishment Subcommittee under the Finance Committee of the LegCo in May 2008, the Administration reported that the target completion date of the whole project had to be revised to July 2010 in view of the statutory requirements and complexities unforeseen at the planning and divestment stages but encountered during the course of the lease and DMC procurement exercise. This revised target date was subsequently publicized through a public announcement made by The Link Management Limited (The Link). The HD further advised the LegCo Panel on Housing on the progress of the lease procurement exercise at its meetings of September 2009 and April 2010 respectively.

14. The HA met the revised target date and completed the whole procurement exercise in July 2010. The Link made a public announcement on the completion of the conveyance of legal title in August 2010. The revised timetable for the transfer of legal title has no adverse financial implications to the HA from the angle of property sale since the purchase price was fully received by the HA at the time of listing. As regards land lease and Government rent, these issues were raised and considered at the time of planning, including the fact that new leases of land are normally granted subject to payment of Government rent, and that after the leases are granted, The Link REIT will need to pay Government rent in respect of the retail and Annex C carparking facilities.

15. The lease procurement exercise did not depend solely on the work of the HA, but also on the Government (including all relevant Government departments) as set out in the Government Agreement and the Property Agreement. During the whole exercise and in accordance with the Government Agreement and Property Agreement, both the HA/HD and the relevant Government departments had respectively strived to expedite the process and complete the exercise within the revised target timeframe. With the concerted efforts of all involved, the revised timetable of July 2010 was met. The Government rent foregone is, hence, as pointed out by the Director of Audit, only a notional figure.

16. That said and although the HA does not have further plans to divest HA's commercial facilities, we will conduct a post-implementation review on the divestment exercise as recommended by the Director of Audit in order to gain from the experience.

Housing Department
May 2011

***Note by Clerk, PAC:** *Annexes A, B and C not attached.*

Our Ref : HDCR4-2/PS/4-35/2
Your Ref : CB(4)/PAC/R56

Tel No. : 2761 5049
Fax No : 2761 7445

30 May 2011

Clerk to Public Accounts Committee
Legislative Council
8 Jackson Road, Central
Hong Kong
(Attention : Ms Macy NG)

Dear Ms Ng,

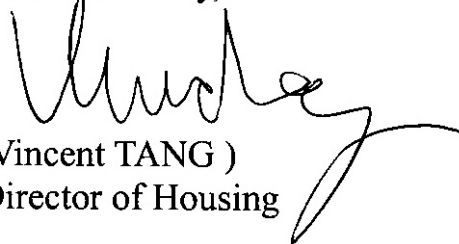
**The Director of Audit's Report on the
results of value for money audits (Report No. 56)**

**Hong Kong Housing Authority:
Management of commercial properties (Chapter 7)**

Thank you for your letter of 25 May 2011.

For the divestment of Hong Kong Housing Authority's retail and car parking facilities, the valuations of the divested properties were carried out by an independent property valuer, CB Richard Ellis Limited. The aggregate market value of the divested properties as determined by the said independent property valuer was \$33.802 billion. Details of the valuation information and the considerations concerned are disclosed and clearly set out in Appendix IV to the Offering Circular (an extract from the said Offering Circular is at **the Annex**).

Yours sincerely,



(Vincent TANG)
for Director of Housing

C.C.

Secretary for Financial Services and the Treasury (Fax No.: 2147 5239)

Director of Audit (Fax No.: 2583 9063)

APPENDIX IV

SUMMARY OF INDEPENDENT PROPERTY VALUER'S
VALUATION REPORTS

VALUATION & ADVISORY SERVICES

CBRE

CB RICHARD ELLIS

世邦魏理仕

CB Richard Ellis Limited
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14 November 2005

The Board of Directors
The Link Management Limited
(for itself as manager of The Link Real Estate
Investment Trust ("The Link REIT") and
for and on behalf of The Link REIT)

Goldman Sachs (Asia) L.L.C.
The Hongkong and Shanghai Banking Corporation Limited
UBS AG acting through its business entity UBS Investment Bank

Dear Sirs

**Hong Kong Housing Authority Retail and Car Parking Facilities Divestment, Hong Kong
(together "The Properties")**

Instructions

We refer to written instructions issued by the Joint Global Coordinators ("JGCs") on behalf of The Link Management Limited ("Letter of Instruction"), requesting formal valuation advice in respect of the abovementioned retail and car parking facilities. We have specifically been instructed to provide our opinion of the Market Value (as defined below) of the remaining leasehold interest in the Properties as at 30 September 2005 subject to all existing and proposed leases/tenancy agreements and occupancy arrangements.

We have prepared comprehensive formal valuation reports (individually a "Report" and collectively the "Reports") in accordance with the requirements of the Letter of Instruction, Chapter 6 of the SFC REIT Code, the Hong Kong Institute of Surveyors ("HKIS") Valuation Standards on Properties (First Edition 2005) and the following international definition of Market Value, namely:

"Market Value is the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, after proper marketing, wherein the parties had each acted knowledgeably, prudently and without compulsion".

Market Value is also defined on the following basis:

"the price at which the property might reasonably be expected to be sold at the date of the valuation assuming:

- i. a willing, but not anxious, buyer and seller;
- ii. a reasonable period within which to negotiate the sale, having regard to the nature and situation of the property and the state of the market for property of the same kind;
- iii. that the property will be reasonably exposed to the market;

- iv. that no account is taken of the value or other advantage or benefit, additional to market value, to the buyer incidental to ownership of the property being valued;
- v. that the seller has sufficient resources to allow a reasonable period for the exposure of the property for sale; and
- vi. that the seller has sufficient resources to negotiate an agreement for the sale of the property."

In adopting this definition of value, we are of the opinion that it is consistent with the international definition of Market Value as advocated by the Royal Institution of Chartered Surveyors ("RICS") and the HKIS.

Reliance on This Letter

For the purposes of this Offering Circular, we have prepared this letter which summarises our Reports and outlines key factors which we have considered in arriving at our opinion of value. This letter alone does not contain the comprehensive data and support information included in our Reports. For further information to that contained herein, reference should be made to the Reports, copies of which are held by the Trustee of The Link REIT.

CB Richard Ellis has provided the Trustee with a comprehensive valuation report for each of the Properties. The valuations and market information are not guarantees or predictions and must be read in conjunction with the following:

- Each Report is approximately 80 to 100 pages in length and the conclusions as to the estimated values are based upon the factual information set forth in the respective Reports. Whilst CB Richard Ellis has endeavoured to assure the accuracy of the factual information, it has not independently verified all information provided by The Link Management Limited ("LML") (primarily copies of leases and financial information with respect to the Properties as well as various reports by independent consultants engaged by LML) or the government of Hong Kong (primarily statistical information relating to market conditions and demographics). The Reports contain detailed information which may be required by investors in order to fully understand the complexity of the methodology and the many variables involved.
- The methodologies used by CB Richard Ellis in valuing the Properties, namely Discounted Cashflow Analysis, Capitalisation Approach and Direct Comparison are based upon estimates of future results and are not predictions. These valuation methodologies are briefly summarised in the Valuation Rationale section of this letter. Each methodology begins with a set of assumptions as to income and expenses of the Properties and future economic conditions in the local market. The income and expense figures are mathematically extended with adjustments for estimated changes in economic conditions. The resultant value is considered the best practice estimate, but is not to be construed as a prediction or guarantee and is fully dependent upon the accuracy of the assumptions as to income, expenses and market conditions. The basic assumptions utilised for each Property are summarised in Valuation Rationale section of this letter.
- The Reports were undertaken based upon information available as at 30 September 2005. CB Richard Ellis accepts no responsibility for subsequent changes in information as to income, expenses or market conditions.

Summary of Divestment Portfolio

The Link REIT portfolio comprises a diverse range of publicly owned retail and car parking facilities within Hong Kong. These properties were originally developed by the Hong Kong Housing

Authority ("HKHA") to service the needs of the estates and local catchments across Hong Kong Island, Kowloon and the New Territories. The tenancy mix within these publicly owned facilities is predominantly locally based and includes supermarkets, large Chinese restaurants, fast-food operators and local convenience and service based outlets.

In total, the portfolio includes 180 properties containing a combined Internal Floor Area ("IFA") of 1,001,441.5 square metres and providing 79,485 car parking spaces. The variety of property types within the portfolio is extensive, ranging from smaller car parking facilities and retail shops to substantial district shopping centres offering higher order comparison based retailing. In terms of value, individual properties within the portfolio range from under HK\$5 million for smaller facilities to in excess of HK\$1.6 billion for the larger assets.

The older facilities include:

- A collection of shops located on the ground floor and in some instances first floor of domestic residential buildings. These facilities typically service local shopping needs and are often disjointed from a traditional retailing perspective, with the design and layout producing difficulties in guiding trade and achieving maximum rental growth. These centres may allow additional fast-food retailing and small destination uses, but only in the highly visible locations.
- Purpose-built retail properties with adjoining market buildings and auxiliary buildings. Built as retail but definitely older style, with their tired appearance often overstating their actual age. These facilities are generally of multi-level design and although they may have originally been the dominant centre in the catchment area, they are now forced to trade as secondary facilities to dominant private retail centres which are typically located at the junction of local transport infrastructure and either built over or adjacent to MTR stations. These centres do not present as well as the private centres and it is anticipated that intensive and pro-active management will be required to introduce new tenants, improve the retail offer, reduce vacancy levels and increase the potential for growth.

New facilities include:

- Purpose-built retail centres typically designed to service developing estates. They are typically air-conditioned or have been retro-fitted and provide the focal point of the estate. In areas where there is more private competition, the trade mix is very local. Centres in more distant locations may offer limited local fashion and sport outlets.
- Larger new centres in larger estates and catchments. The centres may include some secondary branded fashion, jewellery and gift shops. However, the bulk of these centres are still anchored or underpinned by one, possibly two supermarket chains, branded/chain fast-food outlets and large Chinese restaurants.

Within the portfolio there are approximately 10 to 15 centres which we consider to be the best of the Link REIT portfolio, in terms of both size and income security. They are typically new or dominant in their catchment or are situated in locations which benefit from potential tourism. These centres are the trophy assets of the portfolio.

Valuation Rationale

In order to assess the market value of the diverse range of properties included in The Link REIT portfolio, we have considered a broad cross-section of recent retail and carpark sales evidence throughout Hong Kong. The local evidence considered provides an indication of market demand for

these investments and helps to establish appropriate market parameters on which our assessment of value has been based. Given that The Link REIT portfolio is expected to be one of the first major REITs to be launched in Hong Kong, we have additionally had regard to recent market activity involving REIT purchasers in international markets including Singapore in order to establish the fundamental investment criteria utilised by REIT vehicles.

Having regard to the return driven focus of REIT vehicles, the valuation methodology adopted in assessing the market value of the underlying property assets needs to reflect both the investment criteria and reporting requirements of REIT vehicles. As such, we have relied upon discounted cashflow analysis and a capitalisation approach as our primary valuation methods, supported by the direct comparison method. Although retail investments in Hong Kong are typically valued using a direct comparison approach, this method of valuation has inherent limitations in quantitatively reflecting various property specific characteristics including:

- Quality of existing tenant covenants;
- Lease expiry profile;
- Vacancy rate and leasing potential;
- Passing rents in comparison to market;
- Redevelopment potential;
- Potential for turnover and rental growth.

All of these factors are particularly important to REIT vehicles as they directly impact on the cashflow and growth potential associated with the property (and hence the return to investors in the REIT). In relation to the direct comparison approach, these dynamic factors must all be reflected in a single variable, namely the value rate per square metre.

In contrast, both discounted cashflow analysis and the capitalisation approach can accurately reflect these property specific items by utilising individual assumptions which have been verified by market evidence. The ability to adopt specific assumptions to reflect the tenancy and cashflow profile in both these valuation methods is considered to be particularly relevant for REIT based purchasers where delivering returns to investors is of paramount importance.

A brief summary of each of these valuation methods is provided as follows:

Discounted Cashflow Analysis

We have carried out a discounted cashflow analysis over a 10-year investment horizon in which we have assumed that the Property is sold at the commencement of the eleventh year of the cashflow. This form of analysis allows an investor or owner to make an assessment of the long term return that is likely to be derived from a property with a combination of both rental and capital growth over an assumed investment horizon. In undertaking this analysis, a wide range of assumptions are made including a target or pre-selected internal rate of return, rental growth, sale price of the property at the end of the investment horizon, costs associated with the initial purchase of the property and also its disposal at the end of the investment period.

The cashflow analysis, which comprises annual income streams, is based upon the following assumptions:

- We have estimated that inflation will grow at rates between 1.90% and 2.68% per annum during next 10 years, reflecting an average growth rate over the forecast cashflow period of

2.45% per annum. The adopted inflation rates are in line with consensus forecasts as detailed in the Market Consultants Report.

- Rental growth patterns for each individual tenancies and carpark operations reflect the rent review provisions of each lease, including staggered rental increase where applicable. We have assumed that upon expiry of the tenancies and carpark operations, typically new three-year leases will be granted on the basis of a market rent with no annual increases.
- Other income such as advertising and promotions, casual and sundry income have been forecast to increase annually in accordance with income growth.
- We have forecast total outgoings and outgoings recoveries to increase in accordance with inflation, and in addition, we have deducted rates and government rent, both of which increase annually in accordance with the income growth forecast adopted within our calculations.
- An annual vacancy and bad debts allowance has been provided over various properties within the portfolio. These allowances have been calculated as a proportion of gross income (excluding car parking income) and have been deducted throughout the term of the cashflow. These allowances range up to 25%, reflecting the anticipated long term trading position and the likely ongoing level of vacancy within each property.
- An allowance for owner's non-recoverable expenditure calculated initially at 1.0% of gross retail income and forecast to increase in line with inflation is deducted throughout the cashflow.
- Immediate capital expenditure as forecast by Chesterton Petty has been deducted during the first year of the cashflow, together with the ongoing forecast capital expenditure.
- A letting up allowance calculated as three months' gross rent together with an incentive allowance of 0.5 month gross rent has been provided on expiry of existing leases. An assumed renewal probability of between 80% and 85% has been included within our letting up calculations for existing leases. A letting up allowance of 12 months gross rent has been provisioned over existing vacancies.
- The property is assumed sold at the end of year 10 at a price based upon the forecast year 11 income and on the terminal capitalisation rate for the remaining property lease term. Our selected terminal capitalisation rate, used to estimate the terminal sale price, takes into consideration perceived market conditions in the future, estimated tenancy and cashflow profile and the overall physical condition of the building in 10 year's time. The adopted terminal capitalisation rate additionally has regard to the duration of the remaining tenure of the property at the end of the cashflow period.
- Acquisition costs and disposal costs have been deducted, equating to 4% and 0.875% respectively.
- The analysis proceeds on a before tax basis, and whilst we have not qualified any potential taxation benefits associated with the properties, we are of the view that these are issues which a prospective purchaser would reflect in its consideration.
- The analysis is based on the assumption of a cash purchase. No allowance for interest and other funding costs have been made.
- We have discounted the income at each year of the cashflow on a midpoint basis which assumes an income of six months in arrears and six months in advance.

We have investigated the current market requirements for an investment return over a 10-year period from retail and car parking properties. We hold regular discussions with investors active in the

market, both as purchasers and owners of shopping centres. From this evidence, we conclude that market expectations for the portfolio are currently in the order of 8.75% to 9.75%, which we have applied within our calculations. The overall portfolio internal rate of return is in the order of 9.27%.

We note that the prevailing Hong Kong 10-year Exchange Fund Notes ("EFN") is in the order of 4%, indicating a risk premium of between 4.75% and 5.75%. Based on our analysis of comparable sales within the international REIT market, this slightly higher premium reflects the nature of the portfolio and the inherent investment risks associated with the South-East Asia region and the current status of the prevailing bond rate in Hong Kong.

Capitalisation Approach

We have also utilised a capitalisation approach in which the net income on a fully leased basis has been estimated having regard to the current passing rental income and potential future income from existing vacancies. Other income relating to advertising and promotion, casual leasing, sundry items and car parking revenue has additionally been incorporated within our calculations. From this figure, we have deducted outgoings expenditure, rates, government rent, management fees and an ongoing vacancy allowance to reflect possible future vacancies and bad debts. We have additionally incorporated an ongoing other non-recoverable expenditure allowance within our calculations.

The adopted fully leased net income is capitalised over the remaining tenure of the property from the valuation date at appropriate investment yields in order to produce a core capital value. We have applied individual yield to the retail and carpark components of the property to reflect the perceived higher levels of risk associated with the carpark operations. The yields adopted within our calculations generally range from 5.5% to 9.0% for the retail components and from 8.0% to 9.0% for the carpark components. The average initial yield for the portfolio equates to 6.82%. The adopted yields reflect the nature, location and tenancy profile of the various properties together with current market investment criteria, as evidenced by the market evidence considered. Thereafter, appropriate capital adjustments relating to letting up costs associated with existing vacancies, rental reversion adjustments and capital expenditure requirements have been included.

Direct Comparison Approach

As a supporting method of valuation, we have utilised a direct comparison approach to ensure that the overall value rates (per square metre of IFA and per car parking space) indicated by our DCF and capitalisation approach calculations are within market parameters in the context of the sales evidence considered.

Summary of Individual Property Details

Comprehensive details of the 30 largest properties within the portfolio (by value) are provided below together with a summary schedule which outlines our valuation assessment for all properties within the portfolio. We note that the 30 largest properties detailed below represent slightly more than 50% of the total value of the portfolio. The Link REIT will own 100% of all properties.

ACRONYMS AND ABBREVIATIONS

2009 EAG	The Hong Kong 2009 East Asian Games
Audit	Audit Commission
B/Ds	Bureaux/departments
CEDB	Commerce and Economic Development Bureau
CI Panel	Panel on Commerce and Industry
CPC	Commercial Properties Committee
CWFE	Chai Wan Factory Estate
CWRF	Capital Works Reserve Fund
DMCs	Deeds of Mutual Covenant
EAG Company	The 2009 East Asian Games (Hong Kong) Limited
ECAs	Export credit agencies
ECIC	Hong Kong Export Credit Insurance Corporation
EU	Efficiency Unit
FC	Finance Committee
FEHD	Food and Environmental Hygiene Department
FSTB	Financial Services and the Treasury Bureau
GFA	Gross floor area
HA	Hong Kong Housing Authority
HAB	Home Affairs Bureau
HAD	Home Affairs Department
HD	Housing Department
HKSAR	Hong Kong Special Administrative Region
HKSC	Hong Kong Squash Centre
IPO	Initial Public Offering
IRD	Inland Revenue Department

ACRONYMS AND ABBREVIATIONS

KPIs	Key performance indicators
LandsD	Lands Department
LCSD	Leisure and Cultural Services Department
LegCo	Legislative Council
NOCs	National Olympic Committees
NSAs	National Sports Associations
PIR	Post-implementation review
PlanD	Planning Department
RC	Retail and carpark
SARS	Severe Acute Respiratory Syndrome
SF&OC	Sports Federation and Olympic Committee of Hong Kong, China
SWOT	Strength-weakness-opportunity-threat
The Link REIT	The Link Real Estate Investment Trust