

**CHAPTER 5**

**THE GOVERNMENT OF THE  
HONG KONG SPECIAL ADMINISTRATIVE REGION**

**GENERAL REVENUE ACCOUNT**

**GOVERNMENT SECRETARIAT**

**Financial Services and the Treasury Bureau**

**PUBLIC BODY**

**The Legislative Council Commission**

**Subvention for staff emoluments  
of The Legislative Council Commission**

# **SUBVENTION FOR STAFF EMOLUMENTS OF THE LEGISLATIVE COUNCIL COMMISSION**

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# **SUBVENTION FOR STAFF EMOLUMENTS OF THE LEGISLATIVE COUNCIL COMMISSION**

## **Summary and key findings**

### **Introduction**

A. The Legislative Council Secretariat (LCS) operates under The Legislative Council Commission (the LCC), which was established under The Legislative Council Commission Ordinance (the LCCO) enacted in April 1994. The Exchange of Letters (EOL) between the Administration and the LCC sets out the general principles and guidelines governing the administrative arrangements for the LCC and its working relationship with the Administration. Government subvention to the LCC for its recurrent expenditure for each financial year is determined by adjusting the previous year's subvention by the approved addition or reduction of resources allocated to the LCC and then applying to the total amount a price level adjustment factor prescribed by the Financial Services and the Treasury Bureau (FSTB). Expenditure of the LCC is provided under Head 112 of the Estimates and the Secretary General of the LCS is designated as the Controlling Officer for the purposes of the Public Finance Ordinance. There are two recurrent account subheads under this head of expenditure, i.e. Subhead 366 for remuneration and reimbursements for Legislative Council (LegCo) Members and Subhead 367 for staff emoluments and general expenses of the LCC. In the LCC's draft estimates of expenditure forwarded to the FSTB, staff emoluments and general expenses are provided as a one-line vote and appear as a single subhead with no breakdown of expenditure. For the period 1994-95 to 2002-03, 63% of the government subvention was for staff emoluments and general expenses. For the period 1994-95 to 2001-02, staff emoluments of each financial year accounted for nearly 90% of the total expenditure on staff emoluments and general expenses (paras. 1.3, 1.10, 1.11, 1.13, 1.15, 1.16, 1.17 and 1.20).

### **Audit review**

B. Audit has conducted a review on the Government's subvention for staff emoluments of the LCC to examine the provision for cash allowance and contract gratuities. Audit's findings are summarised in paragraphs C to N below (para. 1.21).

### **Roles and responsibilities of Controlling Officers and the FSTB**

C. The Financial and Accounting Regulations state clearly that where Controlling Officers have reason to believe that funds surplus to requirements exist under a subhead, they shall immediately inform the Secretary for Financial Services and the Treasury of such surplus so that the excess may be reserved. The FSTB is responsible for, among others, overseeing the annual Resource Allocation Exercise (RAE) and the compilation of the Government's estimates of expenditure, overseeing in-year management of expenditure and ensuring the probity and propriety of the Government's financial transactions and accounting arrangements. If a Controlling Officer does not inform the FSTB that he

has funds surplus to requirements under a subhead, or the FSTB does not exercise adequate control over the estimates of expenditure submitted by Controlling Officers, over-provision of resources to a government department (or a subvented organisation like the LCC) will result (paras. 2.4(b), 2.6 and 2.8).

#### **Over-provision of subvention for cash allowance**

D. *Subvention for cash allowance not reduced.* Staff of the LCS are paid a monthly cash allowance. Audit notes that the subvention to the LCC for cash allowance had not been reduced to take into account two factors: (a) the significant decrease in the cash allowance rates (CARs) for existing staff on or above point 34 of the Master Pay Scale during the period 1994-95 to 2002-03 and (b) the reduction in subvention requirements because some staff of the LCS chose not to receive cash allowance. The over-provision of subvention to the LCC for cash allowance for the period 1994-95 to 2002-03 amounted to \$30.5 million. Audit considers that the FSTB should have reduced the subvention to the LCC for cash allowance, taking into account the reduction in subvention requirements as a result of these two factors (paras. 3.2 and 3.11).

E. In response to Audit's enquiry in January 2003, the LCC expressed the view that, as the LCC had been operating under the one-line vote arrangement since its inception, funds were not segregated and earmarked for any particular type of expenditure. Thus, the question of over-provision of subvention for cash allowance did not arise and there was no question of making a refund to the Administration on the ground of over-provision of funds to the LCC. However, Audit has pointed out that one basic control in any funding system (particularly for organisations which receive their funding solely from the Government), including the one-line vote arrangement, is a control over the actual subvention requirements at the inception of the arrangement and at times when there are significant changes in circumstances. At these times, thorough vetting by the FSTB is necessary on the expenditure items to ensure the adequacy and reasonableness of funding. Without this basic funding control, the one-line vote arrangement would be deficient and could get out of control. The one-line vote arrangement of the LCC is a case in point. Audit has identified the over-provision of \$30.5 million for cash allowance, which is not a genuine saving achieved by the LCC, as it has claimed. The problem of over-provision needs to be addressed because the over-provision will continue year after year, leading to the unjustified building up of the LCC's reserve (paras. 3.13 and 3.14).

#### **Over-provision of subvention for contract gratuities for new posts and posts not filled by contract staff**

F. *New posts.* Before 2000-01, the FSTB adopted a three-year funding method to provide government subvention for contract gratuities to the LCC. Full funding for contract gratuities was not provided to the LCC until the third year of each three-year funding cycle. Audit's examination of the subvention to the LCC for contract gratuities revealed that for the new posts created during the period 1996-97 to 1998-99, the percentages of the annual contract gratuities included in the subvention to the LCC had been wrongly calculated and, in most cases, a double provision (i.e. additional 85% per year) for these posts had been made. Audit has estimated that, as a result of these calculation errors, the subvention to the LCC during the period 1997-98 to 2002-03 for contract gratuities for the new

posts created during the period 1996-97 to 1998-99 had been over-provided by \$15.3 million. Audit considers that the FSTB should have provided subvention to the LCC for contract gratuities for such new posts according to the appropriate percentages (paras. 4.3 and 4.16).

G. In response to Audit's enquiry in January 2003, the LCC expressed the view that money was provided to the LCC under the one-line vote arrangement. Audit's interpretation of the three-year funding method would require the tracking of each and every post, which was contrary to the rationale of establishing a one-line vote for the LCC. Bids for an RAE had always been calculated at 100% of the annual contract gratuities. However, Audit has pointed out that, under the one-line vote arrangement, there should be a basic control over the actual subvention requirements at the inception of the arrangement and at times when there are significant changes in circumstances. The creation of new posts was such a significant change. The LCS's failure to adjust the amount of resources for the new posts according to the percentage adopted by the three-year funding method had resulted in the over-provision of subvention for contract gratuities (paras. 4.19(a), (b), (c) and 4.20(a), (b), (c)).

H. **Posts not filled by contract staff.** The LCS needed to pay contract gratuities only for those posts filled by contract staff. During the period April 1994 to April 1995, a large number of posts were either filled by civil servants or vacant. The LCS did not have to pay contract gratuities for these posts. In the LCS's funding request for contract gratuities for 1996-97 submitted to the FSTB in May 1995, the LCS's calculation was based on its staff establishment, including all those posts not filled by contract staff during the period April 1994 to April 1995. The FSTB provided subvention to the LCC according to the LCS's calculation. As a result, the LCC had been over-provided with subvention for contract gratuities in the first three-year funding cycle (1994-95 to 1996-97) because of the large number of posts not filled by contract staff during the period April 1994 to April 1995. Audit has estimated that the government subvention to the LCC included contract gratuities of \$5.1 million which were not required. Audit considers that the FSTB should not have provided subvention to the LCC for contract gratuities for those posts which were not filled by contract staff (paras. 4.15 and 4.17).

I. In response to Audit's enquiry in January 2003, the LCC expressed the view that, if the posts filled by civil servants were not taken into account when the LCS applied for the funding of contract gratuities for 1996-97, the LCS would have to track all its posts. This would defeat the purpose of adopting the one-line vote arrangement. However, Audit has pointed out that it is unacceptable for the LCS to have included contract gratuities for the posts not filled by contract staff because this expenditure had not been incurred by the LCC (paras. 4.19(d) and 4.20(d)).

#### **Lack of provision for recouping over-provided subvention**

J. Audit examined the EOL to ascertain whether it was possible for the FSTB to require the LCC to refund to the Government the subvention over-provided to the LCC for cash allowance, and for contract gratuities for the new posts created during the period 1996-97 to 1998-99 and posts not filled by contract staff during the period April 1994 to April 1995, or to make an equivalent reduction in the 2003-04 recurrent subvention to the LCC in order to recoup the over-provision. Audit found that, according to the EOL, there was no provision which enabled the Government to do so. Audit



considers that the lack of such a provision in the EOL is unsatisfactory. The Administration needs to consider amending the EOL to include such a provision (paras. 3.12 and 4.18).

### **Non-compliance with guidelines on the provision of contract gratuities to non-professional and supporting staff**

K. According to the guidelines on the provision of contract gratuities to staff employed on contract terms by subvented organisations stipulated in Finance Bureau Circular Memorandum (FBCM) No. 10/99, in the light of the financial implications involved, Controlling Officers should seek the FSTB's prior agreement if they offer to non-professional and supporting staff contract gratuities of more than 10% of the basic salary. However, Audit noted that as the Controlling Officer, the Secretary General of the LCS had not sought the FSTB's prior agreement on offering contract gratuities to newly recruited non-professional and supporting staff at a level of 15% of their basic salary. Based on the assumption that all existing staff of the LCS were replaced by new appointees and were on the maximum point of their salary scale, the LCS estimated that, if all these staff were paid contract gratuities at 15% of their basic salary irrespective of their rank, the additional amount of contract gratuities payable by the LCC was \$1.3 million per annum. For the period June 1999 to March 2002, the additional amount of contract gratuities actually incurred by the LCC was \$102,000 (paras. 5.6 and 5.8).

L. In response to Audit's enquiry in January 2003, the LCC expressed the view that, in the view of the Legal Adviser of the LCS, FBCM No. 10/99 did not impose an obligation on the LCC or the Secretary General of the LCS to seek the FSTB's prior agreement. However, Audit has pointed out that the LCC did not have strong justifications, based on the prevailing employment market situations, for supporting its decision to offer non-professional and supporting staff contract gratuities at a level of 15% of their basic salary, instead of no more than 10% as stipulated in the FSTB's guidelines in FBCM No. 10/99. The LCC's non-compliance with the Government's guidelines on providing contract gratuities to non-professional and supporting staff is at a variance with the Government's best management practice. The LCC noted Audit's suggestion that it should conduct a review on the justifications for offering contract gratuities at 15% of the basic salary to newly recruited non-professional and supporting staff of the LCS. In any event, Audit considers that, to enhance public accountability, the LCC should adopt the Government's best management practice (i.e. no more than 10% for such staff —paras. 5.12 and 5.13).

### **Maximum reserve of the LCC not set**

M. Surpluses of government subvention for staff emoluments and general expenses under Subhead 367 may be credited to the LCC's Operating Reserve Account for future use. As at 31 March 2002, the balance of this account was \$101.6 million, which is 41% of the subvention for staff emoluments and general expenses of \$246.6 million for 2002-03. According to the Guidelines on the Management and Control of Government Subventions, subject to the FSTB's agreement and the provisions of relevant legislation, a subvented organisation may carry a contingency reserve. A subvented organisation which considers that it needs to carry a reserve must justify the amount of reserve it needs and the intended purposes of the reserve. If, at the end of a financial year, the level of reserve exceeds the approved level, the excess amount will be netted off in the following financial year's subvention. The level of reserve, if any, will be subject to the approval of the Legislature in

the context of the draft Estimates. However, Audit notes that the maximum level of reserve of the LCC has not been mentioned in the EOL. According to the EOL, the reserve may be spent at the discretion of the LCC. Furthermore, the LCC will continue to accumulate additional reserve as long as it has surplus income over expenditure at the end of a financial year (paras. 6.3, 6.4 and 6.7).

N. In response to Audit's enquiry in January 2003, the LCC expressed the view that the LCC's surpluses had been accumulated through its prudent management of funds under the one-line vote arrangement. The LCC considered that setting a maximum level for the LCC's reserve would be inconsistent with the rationale of the one-line vote funding arrangement. However, Audit has pointed out that, due to the provision of government funds for expenditure which was actually not required by the LCC, there had been over-provisions of subvention totalling \$50.9 million over the past nine years. The FSTB's failure to adjust the subvention, despite being aware of the decrease in the subvention requirements for cash allowance and contract gratuities, had led to the unjustified building up of the LCC's reserve. For many subvented organisations (e.g. the Hospital Authority) receiving similar block grant funding, the Government has set different levels of maximum reserve, up to which such organisations are allowed to keep their unspent funds. Audit considers that, in line with the Guidelines on the Management and Control of Government Subventions, the FSTB needs to set a maximum level of reserve which the LCC would be allowed to keep (paras. 6.8 to 6.10).

#### **Audit recommendations**

O. Audit has made the following major recommendations that the Secretary for Financial Services and the Treasury should:

##### ***Over-provision of subvention for cash allowance and contract gratuities for new posts and posts not filled by contract staff***

- (a) take prompt action to reduce the subvention to the LCC for 2003-04, in order to rectify the over-provision of subvention for cash allowance and contract gratuities for the new posts created during the period 1996-97 to 1998-99 (paras. 3.15(a) and 4.21(a));
- (b) consider amending the EOL to include a provision that the Administration may recoup the over-provision of subvention for cash allowance and contract gratuities by way of an adjustment to the subvention in subsequent years (paras. 3.15(b) and 4.21(b));

##### ***Non-compliance with guidelines on the provision of contract gratuities to non-professional and supporting staff***

- (c) seek the Department of Justice's advice as to whether the LCCO has conferred discretionary powers on the LCC to offer contract gratuities to staff of the LCS at a level higher than that prescribed by the FSTB, without seeking the FSTB's prior agreement. In

any event, to enhance public accountability, the FSTB should urge the LCC to adopt the Government's best management practice (para. 5.14); and

***Maximum reserve of the LCC not set***

- (d) consider setting a maximum level of reserve which the LCC would be allowed to keep, having regard to its operating needs for, and the past spending pattern of, the subvention for staff emoluments and general expenses (para. 6.11).

**Response from the Administration**

P. The Secretary for Financial Services and the Treasury has agreed with Audit's recommendation in paragraph O(c) above. Regarding Audit's recommendation in paragraph O(d) above, he has said that there is no imminent and practical need for setting a ceiling for the reserve and, subject to the view of the LCC, the FSTB would not object to having such a ceiling. Regarding Audit's recommendations in paragraph O(a) and (b) above, he has said that in line with the one-line vote arrangement, the FSTB takes a broadbrush approach in arriving at the annual estimates of the subvention to the LCC for Subhead 367. The FSTB does not determine the level of annual subvention to the LCC by components such as salaries and cash allowances. The FSTB does not agree that there is an over-provision of subvention to the LCC (paras. 3.16, 4.22, 5.15(b) and 6.12).

**Audit views on the response from the Administration**

Q. Ascertaining the actual subvention requirements is an essential control which should be incorporated into any funding scheme, including the one-line vote arrangement. The FSTB failed to exercise the basic funding control by vetting the actual funding requirements arising from the changed circumstances, i.e. the continual decreasing trend of the CARs, the creation of new posts and the secondment of civil servants to the LCS. The failure had resulted in the over-provision of subvention to the LCC. It would be contrary to the principle of prudent financial management if the one-line vote arrangement precludes the Government from making an adjustment to the subvention to the LCC, even though there was evidence of a major change in the subvention requirements. Furthermore, in view of the rapid building up of the LCC's reserve, there is a need for the FSTB to set a ceiling for the LCC's reserve (paras. 3.17, 4.23 and 6.13).

## **PART 1: INTRODUCTION**

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

### **Background**

1.2 The Legislative Council (LegCo) is the Legislature of the Hong Kong Special Administrative Region. Before April 1994, administrative support and services were provided to the LegCo by two separate administrative units, namely the Office of the Clerk to the Legislative Council (OCLC) and the Office of the Members of the Legislative Council (OMLEGCO). The OCLC was part of the Government Secretariat and was staffed by civil servants. The OMLEGCO was managed by LegCo Members and its staff included both civil servants on secondment and contract staff employed directly by the OMLEGCO on the same remuneration packages as their counterparts in the civil service.

1.3 In April 1994, to achieve maximum efficiency and effectiveness in the provision of administrative support and services to the LegCo, the OCLC and the OMLEGCO were merged to form the Legislative Council Secretariat (LCS). The LCS operates under The Legislative Council Commission (the LCC), which was established under The Legislative Council Commission Ordinance (the LCCO — Cap. 443) enacted in April 1994. The LCCO provides the legal framework for the LCC to direct the operation of the LCS. Under section 15 of the LCCO, the LCC appoints the Secretary General as the chief executive of the LCS and the Clerk to the LegCo. As at 1 January 2003, the establishment of the LCS was 313 and its strength was 306.

### **Membership and powers of the LCC**

1.4 The LCC comprises 13 members, namely:

- (a) the President of the LegCo, who is the Chairman of the LCC;
- (b) the Chairman of the House Committee of the LegCo, who is the Deputy Chairman of the LCC;
- (c) the Deputy Chairman of the House Committee of the LegCo; and
- (d) ten other members elected by and from among LegCo Members.

According to section 17 of the LCCO, the LCC shall not, in relation to the formulation and execution of managerial and financial policies of it or the LCS, be subject to any direction or control

of any person. However, the LegCo may give directions to the LCC in relation to the performance of the LCC's functions or the exercise of the LCC's powers and the LCC shall comply with those directions.

## **Mode of funding the LCC**

1.5 The present arrangements of funding the LCC are described in paragraphs 1.10 to 1.20 below. However, to gain a better understanding of the background to the present funding arrangements, it is necessary to report in paragraphs 1.6 to 1.9 below how the mode of government funding had been changed from the government department approach of funding the former OMLEGCO to the one-line vote approach of funding the LCC.

## **Background to the change in the mode of funding in 1994**

1.6 Before April 1994, the OMLEGCO Secretariat was funded in a way similar to all government departments through a head of expenditure. Under this arrangement, the departments/organisations prepared their own estimates each year for discussion with and agreement by the Administration for consolidation in the annual Appropriation Bill, followed by voting of funds by the Finance Committee (FC) of the LegCo.

1.7 Before the LCC was created in April 1994, in 1993, the LegCo President's Working Group on the Proposed Reorganisation of the LCS considered various options about the future mode of funding. The Working Group considered that a one-line vote mode of funding should be adopted. Under this arrangement, the future LCC would agree its budget with the Administration for inclusion as a subhead in the annual Appropriation Bill. After the voting of funds by the Legislature, the future LCC would receive funding from the Administration at regular intervals throughout the year to meet expenses for salaries and other charges. For the purpose of the Public Finance Ordinance (PFO —Cap. 2), a Controlling Officer would be designated. The Controlling Officer would be accountable to the Legislature for the funds approved and would see to it that funds were paid to the future LCC in the manner agreed.

1.8 The Working Group noted that:

- (a) a set of comprehensive guidelines and procedures had been developed governing the relationship between the Administration and some subvented organisations funded in this way. This was a common device for the management and control of government funding to some subvented organisations and public bodies (e.g. the Hong Kong Trade Development Council and the Hospital Authority); and
- (b) the advantage of this arrangement was flexibility in the use of funds under the relevant subheads of expenditure by allowing deviations from the approved budget within the parameters set by the guidelines. In addition, there was provision for exempting an organisation from certain guidelines, where appropriate.

1.9 The Working Group recommended that a new head of expenditure should be created specifically for the future LCC with only two subheads, one for the expenses of the LCS including staff salaries and allowances and the other for LegCo Members' salaries and allowances.

## **Present procedures of funding the LCC**

### **Exchange of Letters between the Administration and the LCC**

1.10 The Exchange of Letters (EOL) between the Administration and the LCC sets out the general principles and guidelines governing the administrative arrangements for the LCC and its working relationship with the Administration. The provisions of the EOL are made on the principle that the LCC has managerial and financial autonomy in organising its own administration and support facilities as is compatible with the provisions of the LCCO. The EOL also sets out that:

- (a) savings and income of the LCC may be spent at the discretion of the LCC subject to the proviso that no such expenditure shall create a commitment on government funds without the prior approval of the Secretary for Financial Services and the Treasury; and
- (b) any surplus of income over expenditure at the end of the financial year may be kept in the reserve of the LCC. The reserve may be spent at the discretion of the LCC subject to the proviso that no such expenditure shall create a commitment on government funds without the prior approval of the Secretary for Financial Services and the Treasury.

### **Determination of subvention to the LCC**

1.11 Government subvention to the LCC for its recurrent expenditure for each financial year is determined by adjusting the previous financial year's subvention by the approved addition or reduction of resources to the LCC and then applying to the total amount a price level adjustment factor prescribed by the Financial Services and the Treasury Bureau (FSTB —Note 1). The price level adjustment factor is calculated according to the latest civil service salary adjustment and price movement forecasts (supplied by the Census and Statistics Department) for other general expenses.

### **Preparation of the LCC's annual draft estimates of expenditure**

1.12 According to the EOL, the Secretary General of the LCS will prepare the LCC's annual draft estimates of expenditure in accordance with directions or instructions given generally by the Financial Secretary for that purpose. The LCC's annual draft estimates of expenditure shall be forwarded to the FSTB direct for consideration and processing. Upon agreement by the Administration, they are incorporated into the draft estimates of expenditure for the following financial year.

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**Note 1:** *With the implementation of the Accountability System, with effect from 1 July 2002, the FSTB took over the statutory functions of the Finance Bureau.*

## **Provision for expenditure of the LCC**

1.13 Expenditure of the LCC is provided under Head 112 of the Estimates. There are two recurrent account subheads under this head of expenditure, namely Subhead 366 for remuneration and reimbursements for LegCo Members and Subhead 367, in the form of a one-line vote, for staff emoluments and general expenses of the LCC. Virement between these subheads is not permitted because the purposes of each subhead are different. In addition, there are capital account subheads for specified purposes with approved funding commitments.

1.14 If the provision for Subhead 366 is insufficient to meet the requirement as a result of the adjustment of rates for LegCo Members' remuneration and reimbursements, supplementary provision may be sought to meet the shortfall. However, the provision for Subhead 367 will not be increased during the course of a financial year, except where additional funds are required to meet the cost of:

- (a) salaries and allowances in accordance with approved rates and scales;
- (b) benefits for staff of the LCS in the event of duty-related death or injury under an option for those affected staff to receive the same level of entitlements as civil servants;
- (c) reimbursement of medical expenses incurred by staff of the LCS during duty visits or training outside Hong Kong;
- (d) payments for statutory or employment obligations; and
- (e) new or additional services introduced by the LCC at the request of the Administration.

## **Staff emoluments and general expenses provided as a one-line vote**

1.15 In the LCC's draft estimates of expenditure forwarded to the FSTB, staff emoluments and general expenses are provided as a one-line vote and appear as a single subhead with no breakdown of expenditure. The LCC's own budget with breakdown of expenditure (such as salaries and allowances) is provided to the FSTB for information but not for control. The breakdown of the one-line vote does not limit the LCC's spending among different lines of expenditure, for as long as the overall provision is not exceeded. The one-line vote arrangement facilitates the LCC in:

- (a) speeding up its decision-making process in resource management. It enables the LCC to respond to changes more promptly;

- (b) developing a sense of ownership which in turn encourages more innovative thinking in better utilisation of resources; and
- (c) providing the LCC with the flexibility to decide on the most optimal mix of manpower and other input resources to do its work.

### **Subvention for staff emoluments**

1.16 The actual amounts of government subvention for different types of expenditure of the LCC for the period 1994-95 to 2002-03 are summarised in Appendix A. It can be observed from Appendix A that for this period, 63% of the government subvention was for staff emoluments and general expenses.

1.17 The actual amounts of the LCC's expenditure on staff emoluments for the period 1994-95 to 2001-02 are summarised in Appendix B. It can be observed from Appendix B that for this period, staff emoluments of each financial year accounted for nearly 90% of the total expenditure on staff emoluments and general expenses.

### **Funding for new or improved services**

1.18 Where the LCC requires additional funds for introducing new or improved services, it will submit bids in the annual Resource Allocation Exercise (RAE). Such bids will be considered by the Administration in competition with other bids for public funding.

### **Payments to the LCC**

1.19 The annual government funding to the LCC is drawn by the Secretary General of the LCS in twelve equal monthly instalments in advance. This arrangement may be varied at the request of the LCC in circumstances where the LCC can demonstrate that the arrangement is causing cash-flow problems.

### **Secretary General as the Controlling Officer**

1.20 Under section 16 of the LCCO, the Secretary General of the LCS is designated as the Controlling Officer in respect of the estimates of expenditure of the LCC for the purposes of the PFO. Section 13 of the PFO states that every Controlling Officer shall obey all regulations made and directions or instructions given by the Financial Secretary. However, such powers of the Financial Secretary can only be exercised in respect of the LCC to a limited extent. This is because section 16(2) of the LCCO provides that the powers conferred by the PFO on the Financial Secretary under section 11 of the PFO to make administrative regulations and give administrative directions and instructions to Controlling Officers for the control and management of public finances which are concerned solely with the expenditure of the LCC shall not apply to the Secretary General of the LCS, unless the Financial Secretary has consulted the LCC beforehand.



## **Audit review**

1.21 Audit has conducted a review on the Government's subvention for staff emoluments of the LCC. The audit objectives were to examine:

- (a) the roles and responsibilities of Controlling Officers and the FSTB (see PART 2 below);
- (b) the provision of subvention to the LCC for cash allowance (see PART 3 below);
- (c) the provision of subvention to the LCC for contract gratuities for new posts created and posts not filled by contract staff (see PART 4 below);
- (d) the level of contract gratuities provided to non-professional and supporting staff (see PART 5 below); and
- (e) the reserve of the LCC (see PART 6 below).

## **General response from the LCC**

1.22 The LCC has said that it is disappointed that the special constitutional status of the Legislature as reflected in the provisions in the LCCO and the funding arrangement for the LCC laid down in the EOL have not been understood. The LCC particularly disagrees with the statement in paragraph 3.14(a) below that "One basic control in any funding system, including the one-line vote arrangement, is a control over the actual subvention requirements at the inception of the arrangement and at times when there are significant changes in circumstances.", because such a control measure renders impossible the flexible deployment of resources promoted under the one-line vote funding arrangement (Note 2).

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**Note 2:** *Audit appreciates the merits of flexibility in the deployment of resources under the one-line vote arrangement. However, Audit considers that such flexibility should not be accorded at the expense of basic controls if it leads to significant over-provision of subvention, particularly at the present time of severe budget deficits.*

## **PART 2: ROLES AND RESPONSIBILITIES OF CONTROLLING OFFICERS AND THE FSTB**

2.1 This PART sets out the roles and responsibilities of Controlling Officers (e.g. the Secretary General of the LCS) and the FSTB, in order to facilitate a better understanding of the issues raised by Audit in PARTs 3 to 6 of this report.

### **Roles and responsibilities of Controlling Officers**

2.2 Under the PFO, and for purposes of accountability, a Controlling Officer must be specified for each head and subhead of expenditure in the annual Estimates. A Controlling Officer is responsible and accountable for all expenditure from any head or subhead under his control. In discharging his responsibilities, he is expected to ensure that the services his department provides are of quality, efficient, economic and effective. He is also accountable for all government property and public moneys in respect of the department or service for which he is responsible. Specific and detailed guidance on how he should discharge his responsibilities are set out in the Financial and Accounting Regulations (FARs) and Standing Accounting Instructions (SAIs), Financial Circulars and Accounting Circulars.

### **Expenditure control**

2.3 **SAIs.** SAI 600 states that in discharging their responsibilities, Controlling Officers must ensure that, among other things:

- (a) expenditure is only incurred within the limits authorised and the ambit of the subhead;
- (b) strict economy is exercised in the expenditure under their control (ref. FAR 320(1), (2) and (3) —see para. 2.4 below); and
- (c) expenditure is kept under regular review and supplementary provision is sought only as a last resort.

2.4 **FARs.** FAR 320 states clearly that:

- (a) it is the responsibility of Controlling Officers to exercise strict economy in the expenditure of funds under their control;
- (b) **where Controlling Officers have reason to believe that funds surplus to requirements exist under a subhead, they shall immediately inform the Secretary for Financial Services and the Treasury of such surplus so that the excess may be reserved; and**

- (c) in no circumstances may surplus funds be spent unnecessarily, for example by drawing unallocated stores in excess of reasonable requirements, simply because they are available and would otherwise lapse at the close of the financial year.

## **Roles and responsibilities of the FSTB**

2.5 The main responsibilities of the FSTB are:

- (a) **Strategic role.** This includes supporting the Financial Secretary on matters of fiscal policy, overseeing the Government's investments and loans portfolio, maintaining overall controls on expenditure and promoting value for money across the Government; and
- (b) **Central functions.** These include providing advice and guidance to bureaux and departments, coordinating the annual RAE and preparation of the Estimates, and developing and promulgating regulations and circulars on financial matters, accounts, and the procurement of goods and services.

2.6 The FSTB is the executive agency which assists the Financial Secretary to discharge his responsibilities. Its work covers:

- (a) planning and monitoring the Government's overall finances;
- (b) **overseeing the annual RAE and the compilation of the Government's estimates of expenditure;**
- (c) ensuring that sufficient revenue is raised to meet current and foreseeable needs of the Government;
- (d) ensuring that the system by which the Government receives taxes and dues is as simple, effective and productive as possible;
- (e) **overseeing in-year management of expenditure and ensuring the probity and propriety of the Government's financial transactions and accounting arrangements;**
- (f) overseeing the Government's investment portfolio;
- (g) evaluating the implications of policy proposals, infrastructural proposals and the financial aspects of land-related matters; and

- (h) providing policy direction on revenue measures, financial and accounting arrangements, government procurement, government land transport, government printing, government information technology services, and the management of the government estate.

2.7 On the one-line vote mode of funding, in 1998, the FSTB advised the Heads of Department (HoDs) that:

- (a) within the one-line vote, departments would be given complete flexibility. However, because the PFO required the approval for the “establishment of posts”, the FSTB would need to continue seeking Notional Annual Mid-point Salaries approval in the context of the annual Estimates and the FC’s approval for the creation of directorate posts;
- (b) the FSTB would prepare the draft Estimates on the same price basis as at present, i.e. current salary scales but outturn prices for the non-personal emoluments element of the one-line vote. The FSTB would need to agree administratively on the personal emoluments content of the one-line vote and would undertake to give supplementary provision on this element in line with the actual civil service pay award; and
- (c) in agreeing on the personal emoluments element of the one-line vote, the FSTB would need to look more critically than hitherto at the sum required, with particular attention to likely vacancy levels and the likely effect of staff wastage (e.g. an officer leaving and being replaced by a new recruit at a lower salary point).

### **Audit observations on the roles and responsibilities of Controlling Officers and the FSTB**

2.8 Under the one-line vote, if a Controlling Officer does not inform the FSTB that he has funds surplus to requirements under a subhead, or the FSTB does not exercise adequate control over the estimates of expenditure submitted by Controlling Officers, over-provision of resources to a government department (or a subvented organisation like the LCC) will result. In this report, Audit highlights excess fund provisions to the LCC for:

- (a) cash allowance (see PART 3); and
- (b) contract gratuities for new posts and posts not filled by contract staff (see PART 4).

### **PART 3: SUBVENTION FOR CASH ALLOWANCE**

3.1 This PART examines the subvention to the LCC for cash allowance and suggests measures for improvement.

#### **Cash allowance entitlement**

3.2 Staff of the LCS are paid a monthly cash allowance in lieu of benefits in the form of housing, passage and education allowances (which are available to officers of similar ranks in the civil service) and for offsetting the reduction in leave entitlement. They are divided into three categories according to the salary scale of their rank, namely:

- (a) **Category I staff.** These include directorate staff and staff on points 45 to 49 of the Master Pay Scale (MPS);
- (b) **Category II staff.** These include staff on MPS points 34 to 44; and
- (c) **Category III staff.** These include staff below MPS point 34.

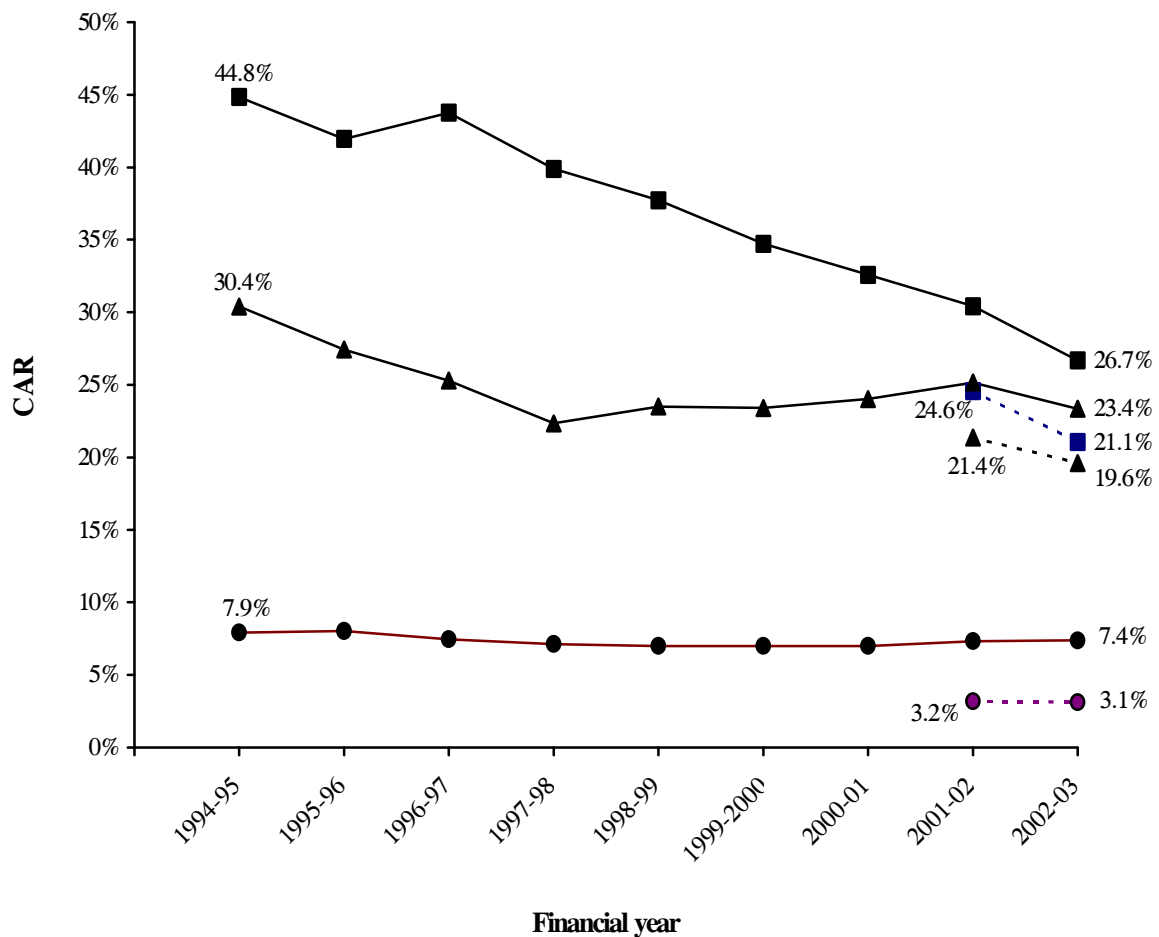
3.3 For each category of staff, there are two cash allowance rates (CARs —see para. 3.4 below). These CARs are determined with reference to the weighted average of the on-costs of the fringe benefits for different ranks of staff in each category as published in the Treasury's Staff Cost Ready Reckoner. The cash allowance of a staff member of the LCS is calculated by multiplying the mid-point salary of his rank by the CAR for his category. The amount of cash allowance is stated in the letter of appointment and is fixed throughout the period of agreement, which is usually three years. CARs are reviewed in April each year following the annual adjustment to the Treasury's Staff Cost Ready Reckoner. Serving staff whose agreements have not expired will not be affected immediately by the new CARs. New CARs will only apply to serving staff upon renewal of agreements and to new appointees.

#### **CARs have decreased during the period 1994-95 to 2002-03**

3.4 As a result of the Government's reduction in spending on the fringe benefits of the civil service, CARs for staff of the LCS have been decreasing during the period 1994-95 to 2002-03. Furthermore, with effect from 1 April 2001, following the implementation of a new entry system to the civil service and a revised fringe benefit package for new recruits to the civil service, the LCC has adopted a separate set of CARs for new recruits. The CARs for new recruits are lower than the CARs for staff of the LCS employed before 1 April 2001. Since then, there have been two CARs for each category of staff. The higher CAR is applicable to staff employed before 1 April 2001 while the lower CAR is applicable to staff employed on or after 1 April 2001.

3.5 The CARs for the three categories of staff of the LCS are shown in Figure 1 below. It can be seen from Figure 1 that the CARs for Category I and Category II staff have decreased substantially (mainly due to deflation and reduction in fringe benefits) during the period 1994-95 to 2002-03. The CAR for Category I staff employed before 1 April 2001 has decreased by 40.4% (from 44.8% to 26.7%), while the CAR for Category II staff employed before 1 April 2001 has decreased by 23% (from 30.4% to 23.4%). The CAR for Category III staff employed before 1 April 2001 has also decreased by 6.3% (from 7.9% to 7.4%).

**Figure 1**  
**CARs for the period 1994-95 to 2002-03**



Legend: **For staff employed before 1 April 2001:**  
 —■— Category I staff  
 —▲— Category II staff  
 —●— Category III staff

**For staff employed on or after 1 April 2001:**  
 - - ■ - - Category I staff  
 - - ▲ - - Category II staff  
 - - ● - - Category III staff

Source: Audit's analysis based on LCS's records

3.6 In March 2001, the FSTB informed the LCC that, because of the adoption of a new set of lower CARs for new recruits, government subvention to the LCC would be adjusted in the light of actual savings achieved. For the years 2001-02 and 2002-03, as no actual savings in this respect had been achieved at the time of preparing the previous financial year's total expenditure, no adjustment to the subvention was made.

### **Some staff of the LCS chose not to receive cash allowance**

3.7 An employee of the LCS may choose not to receive the cash allowance in order to retain his/her spouse's eligibility for fringe benefits (relating to housing, passage or education) if the spouse is:

- (a) a civil servant or an employee of a publicly funded organisation; and
- (b) in receipt of any of such benefits.

As some staff of the LCS chose not to receive cash allowance, the LCC's requirement for subvention for cash allowance had decreased.

### **Subvention exceeded the LCC's budget**

3.8 In December 1993, the FSTB included in the subvention to the LCC a provision of \$19.5 million (see Table 1 in para. 3.9 below) for the payment of cash allowance in 1994-95. In subsequent years, in accordance with the mechanism for determining the subvention as mentioned in paragraph 1.11 above, the FSTB calculated the total government subvention for recurrent expenses of the LCC by applying the prescribed price level adjustment factor to the total of the previous financial year's government subvention and the approved addition or reduction of resources allocated to the LCC. However, the FSTB had not taken into account:

- (a) the significant decrease in CARs during the period 1994-95 to 2002-03; and
- (b) the fact that some staff of the LCS chose not to receive cash allowance.

3.9 Audit calculated the provision for cash allowance included in government subvention to the LCC, using a methodology similar to that adopted by the FSTB to calculate the total government subvention to the LCC as described in paragraph 1.11 above. In doing so, Audit calculated the subvention for cash allowance for each financial year by adjusting the previous financial year's subvention by the approved additional resources allocated to the LCC for cash allowance and then applying to the total amount the price level adjustment factor prescribed by the FSTB. Table 1 below shows the difference between the provision for cash allowance included in the government

subvention to the LCC (as calculated by Audit) and the LCC's budget for cash allowance. For the nine-year period from 1994-95 to 2002-03, the total provision of subvention to the LCC for cash allowance has exceeded the LCC's budget for that purpose by \$30.5 million (see Table 1 below — Note 3).

**Table 1**  
**Over-provision of subvention for**  
**cash allowance for the nine-year period from 1994-95 to 2002-03**

Year	Subvention (Note)	LCC's budget	Over-provision
	(a)	(b)	(c) = (a) - (b)
	(\$ million)	(\$ million)	(\$ million)
1994-95	19.5	19.5	-
1995-96	22.1	21.0	1.1
1996-97	23.0	21.3	1.7
1997-98	25.7	22.8	2.9
1998-99	28.5	24.5	4.0
1999-2000	29.6	24.1	5.5
2000-01	29.6	24.3	5.3
2001-02	30.7	26.1	4.6
2002-03	31.7	26.3	5.4
<b>Total</b>	<b><u>240.4</u></b>	<b><u>209.9</u></b>	<b><u>30.5</u></b>

Source: Audit's computation based on LCS's records

Note:  $Subvention = (Previous\ financial\ year's\ provision + Provision\ for\ approved\ new\ posts) \times (1 + Price\ level\ adjustment\ factor) + Supplementary\ provision\ (if\ any)$

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**Note 3:** For each year during the period 1994-95 to 2001-02 (the 2002-03 figures not yet available), the LCC's budget for cash allowance also exceeded the actual amount of cash allowance paid by the LCC.



3.10 Table 2 below shows an analysis of the over-provision of subvention to the LCC for cash allowance. The total over-provision of \$30.5 million of subvention for cash allowance arose for the following reasons:

- (a) \$22.7 million of subvention was not required due to the decrease in CARs; and
- (b) \$7.8 million of subvention was not required because some staff of the LCS chose not to receive cash allowance.

**Table 2**

**Analysis of over-provision of subvention for cash allowance  
for the nine-year period from 1994-95 to 2002-03**

Year	Over-provision due to decrease in CARs	Over-provision because some staff chose not to receive cash allowance	Total over-provision
	(a)	(b)	(c) = (a) + (b)
	(\$ million)	(\$ million)	(\$ million)
1994-95	-	-	-
1995-96	1.1	-	1.1
1996-97	1.0	0.7	1.7
1997-98	1.9	1.0	2.9
1998-99	2.8	1.2	4.0
1999-2000	4.1	1.4	5.5
2000-01	3.5	1.8	5.3
2001-02	3.5	1.1	4.6
2002-03	4.8	0.6	5.4
<b>Total</b>	<b><u>22.7</u></b>	<b><u>7.8</u></b>	<b><u>30.5</u></b>

Source: Audit's computation based on LCS's records

## **Audit observations on the subvention for cash allowance**

3.11 Audit notes that the subvention to the LCC for cash allowance had not been reduced to take into account:

- (a) the significant decrease in CARs for existing Category I and Category II staff during the nine-year period from 1994-95 to 2002-03 (see paras. 3.4 and 3.5 above). In this connection, it is worthy of note that in March 2001, the FSTB informed the LCC that the government subvention to the LCC for cash allowance would be adjusted for the savings (which were anticipated to be small) achieved with the adoption of a new set of reduced CARs for new recruits; and
- (b) the reduction in subvention requirements because some staff of the LCS chose not to receive cash allowance (see para. 3.7 above).

**Had the FSTB done so, the subvention to the LCC for cash allowance for the nine-year period from 1994-95 to 2002-03 would have been reduced by \$30.5 million (see para. 3.10 above). Audit considers that the FSTB should have reduced the subvention to the LCC for cash allowance, taking into account the reduction in subvention requirements as a result of the significant decrease in CARs and some staff of the LCS having chosen not to receive cash allowance.**

3.12 Audit examined the EOL to ascertain whether it was possible for the FSTB to require the LCC to refund to the Government the excess subvention to the LCC for cash allowance for the nine-year period from 1994-95 to 2002-03 or to make an equivalent reduction in the 2003-04 recurrent subvention to the LCC in order to recoup the subvention for cash allowance over-provided. **Audit found that, according to the EOL, there was no provision which enabled the Government to do so. Audit considers that the lack of provision in the EOL to enable the FSTB to recoup the over-provision of subvention for cash allowance to the LCC is unsatisfactory. The Administration needs to consider amending the EOL to include such a provision.**

## **LCC's comments on the audit observations**

3.13 In January 2003, Audit sought the LCC's views on Audit's observations mentioned in paragraphs 3.11 and 3.12 above. In response, in February and March 2003, the LCC informed Audit that:

- (a) since its inception, the LCC had been operating under the one-line vote arrangement, which did not segregate and earmark funds for any particular type of expenditure. The movement of CARs is not an adjustment factor under the funding mechanism in respect of cash allowance mutually agreed between the Administration and the LCC. However, Audit had assumed that funds were earmarked for particular posts and for particular components of staff emoluments, and that the way such funds had been expended for a certain post might be and should be tracked on a year-by-year basis. Any funds provided which were not spent in subsequent years thus identified were regarded by Audit as over-provision (see audit views in para. 3.14(a) below);
- (b) it appeared that Audit had disregarded the LCC's financial autonomy conferred on it by the LCCO and the LCC's power to redeploy its resources under the one-line vote arrangement (see audit views in para. 3.14(b) below); and
- (c) on the question of refunding to the Government the over-provision of subvention for cash allowance received during the period 1994-95 to 2002-03, the LCC was of the view that, as funding to the LCC had been provided under the one-line vote arrangement under which provisions were not itemised for specific components, the question of over-provision of subvention for cash allowance did not arise. It followed that there was no question of making a refund to the Administration on the ground that there had been purported over-provision of funds to the LCC (see audit views in para. 3.14(c) below).

### **Audit views on LCC's comments**

3.14 In the light of the LCC's comments mentioned in paragraph 3.13 above, Audit has the following views:

- (a) accordingly to the paper issued in November 1998 by the then Finance Bureau for briefing the FC on "One-Line Vote for Selected Departments in the 1999-2000 Estimates", it was stated that proper internal controls over the use of public funds and accountability would not be compromised by the adoption of one-line votes. There would be some controls and safeguards. **One basic control in any funding system (particularly for organisations which receive their funding solely from the Government), including the one-line vote arrangement, is a control over the actual subvention requirements at the inception of the arrangement and at times when there are significant changes in circumstances. At these times, thorough vetting by the FSTB is necessary on the expenditure items to ensure the adequacy and reasonableness of funding. Without this basic funding control, the one-line vote arrangement would be deficient and could get out of control. The one-line vote arrangement of the LCC is a case in point. Despite the significant changes in**

circumstances (e.g. the decrease in CARs and LCS staff's option not to receive cash allowance), the FSTB failed to exercise the basic funding control by ascertaining the actual requirements and adjusting the subvention for the years following the changes. Furthermore, the Secretary General of the LCS, as the vote controller, has a duty to exercise proper control of the public funds under the one-line vote arrangement. The LCS keeps detailed records of cash allowance payments, including the movement of CARs. Therefore, the LCS could have used such information to advise the FSTB of its actual funding needs so as to avoid the over-provision of subvention for cash allowance;

- (b) Audit appreciates the LCC's financial autonomy which is, in fact, not the point at issue. The crux of the matter is the need for basic funding control under the one-line vote arrangement; and
- (c) Audit has identified the over-provision of \$30.5 million for cash allowance, which is not a genuine saving achieved by the LCC, as it has claimed (see para. 6.8 below). **The problem of over-provision needs to be addressed because the over-provision will continue year after year, leading to the unjustified building up of the LCC's reserve.**

#### **Audit recommendations on the subvention for cash allowance**

3.15 **Audit has *recommended* that the Secretary for Financial Services and the Treasury should:**

- (a) **take prompt action to reduce the subvention to the LCC for 2003-04 in order to rectify the over-provision of subvention for cash allowance; and**
- (b) **consider amending the EOL to include a provision that the Administration may recoup the over-provision of subvention for cash allowance by way of an adjustment to the subvention in subsequent years.**

#### **Response from the Administration**

3.16 **The Secretary for Financial Services and the Treasury has said that:**

- (a) it is inherent in the one-line vote arrangement agreed between the Administration and the LCC that the subvention to the LCC may exceed the LCC's budget and conversely, may fall short of the LCC's budget. The FSTB does not determine the level of annual

subvention to the LCC by components such as cash allowance. The FSTB does not claw back the subvention from the LCC when, for a year, the subvention exceeds the LCC's actual expenditure. Conversely, the FSTB does not increase the subvention to the LCC if the subvention falls short of the LCC's actual expenditure (see **audit views in para. 3.17(a) below**); and

- (b) under the agreed one-line vote arrangement with the LCC, there is no such thing as subvention to the LCC for cash allowance because the funding to the LCC is provided as a block grant. The FSTB does not agree that, for the nine-year period from 1994-95 to 2002-03, there is an over-provision of subvention to the LCC for cash allowance and the subvention to the LCC for cash allowance should have been reduced (see **audit views in para. 3.17(b) below**).

### **Audit views on the response from the Administration**

3.17 In response to the comments made by the Secretary for Financial Services and the Treasury in paragraph 3.16 above, Audit has the following views:

- (a) as mentioned in paragraph 3.14(a) above, the FSTB failed to exercise the basic funding control by vetting the actual funding requirements when there were significant changes in circumstances. **Audit considers that ascertaining the actual subvention requirements is an essential control which should be incorporated into any funding scheme (particularly for organisations which receive their funding solely from the Government), including the one-line vote arrangement.** In this connection, it is worthy of note that in March 2001, the FSTB informed the LCC that, because of the adoption of a new set of lower CARs for new recruits, government subvention to the LCC would be adjusted in the light of the savings achieved, which were anticipated to be small (see para. 3.11 above). However, the FSTB failed to effect similar adjustments to take account of changes which were more significant (i.e. the decrease in CARs and the LCS staff's option not to receive cash allowance); and
- (b) as mentioned in paragraph 3.14(c), an over-provision of \$30.5 million has been identified by Audit. **It would be contrary to the principle of prudent financial management if the one-line vote funding arrangement precludes the Government from making an adjustment to the subvention to the LCC, even though there was evidence of a major and continual change in the subvention requirements (during the period 1994-95 to 2002-03).** There is a need to establish an adjustment mechanism.

**PART 4: SUBVENTION FOR CONTRACT GRATUITIES FOR  
NEW POSTS AND POSTS NOT FILLED BY CONTRACT STAFF**

4.1 This PART examines the subvention for contract gratuities for new posts created by the LCS during the period 1996-97 to 1998-99 and for posts not filled by contract staff during the period April 1994 to April 1995, and suggests measures for improvement.

**Funding arrangement for contract gratuities adopted by the FSTB**

4.2 Most of the staff of the LCS are employed on contract terms, mainly for three years, and are paid contract gratuities upon satisfactory completion of their contracts. Two funding methods for contract gratuities have been adopted by the FSTB, namely the three-year funding method (see para. 4.3 below) and the “pay-as-you-go” (PAYG) method (see para. 4.4 below).

**Three-year funding method**

4.3 Before 2000-01, the FSTB adopted a three-year funding method to provide government subvention for contract gratuities to the LCC. Full funding for contract gratuities was not provided to the LCC until the third year of each three-year funding cycle. The three-year funding method adopted by the FSTB was as follows:

- (a) **for each of the three years of the funding cycle:**
  - (i) **for posts which already existed when the LCC was established**, based on the LCS’s staff establishment as at 1 April 1994 (when the LCC was established), subvention for 15% of the year’s contract gratuities was included in the normal funding to the LCC; and
  - (ii) **for new posts created in RAEs after 1994-95**, 100% of the annual contract gratuities for the new posts concerned were included in the normal funding to the LCC (Note 4); and
- (b) **for the final year of the funding cycle**, based on the LCS’s staff establishment at the beginning of the second year of the funding cycle (including the new posts created in the second year and all previous years), an additional amount equal to 255% (85% per year × 3 years) of the year’s contract gratuities was provided (see Table 3 in para. 4.4 below).

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**Note 4:** *It is worthy of note that for the new posts created in 1995-96, the subvention for contract gratuities included in the normal funding to the LCC was 15% of the year’s contract gratuities.*

## **PAYG method**

4.4 In September 1999, the FSTB informed the LCC that, to avoid fluctuations in the provisions for contract gratuities and to give the LCC greater incentive to better manage resources, the Government would provide funding for contract gratuities to the LCC based on the PAYG method. With the adoption of the PAYG method in 2000-01, full funding for contract gratuities to be incurred in a year would be provided by the Government to the LCC in that year, as follows:

(a) **for 2000-01:**

- (i) **for posts which already existed when the LCC was established**, based on the LCS's staff establishment as at 1 April 1994 (when the LCC was established), 15% of the year's contract gratuities were included in the subvention to the LCC;
- (ii) **for new posts created in RAEs after 1994-95**, the normal funding to the LCC included the subvention for:
  - 15% of the year's contract gratuities for new posts created in 1995-96; and
  - 100% of the year's contract gratuities for new posts created in subsequent years (see para. 4.3(a)(ii) above); and
- (iii) **for all posts**, based on the LCS's staff establishment as at 1 April 1999, including new posts created in previous years (no new posts were created in 1999-2000 and 2000-01), an additional amount equal to 85% of the year's contract gratuities was provided; and

(b) **for 2001-02 and subsequent years:**

- (i) **for existing posts**, the subvention for contract gratuities in the previous year (included in the normal funding to the LCC) was/would be adjusted by the price level adjustment factor to arrive at the subvention for contract gratuities for the current year because the normal funding to the LCC was adjusted by the price level adjustment factor in the form of a one-line vote; and
- (ii) **for new posts created in the current year**, 100% of the year's contract gratuities were included in the normal funding to the LCC (see para. 4.3(a)(ii) above).

The funding arrangement for contract gratuities is summarised in Table 3 below.

**Table 3**

**Funding arrangement for contract gratuities**

<b>Year</b>	<b>Percentage of annual contract gratuities</b>	<b>Based on staff establishment as at</b>	<b>Remarks</b>
<b>(I) Three-year funding method: first three-year funding cycle</b>			
1994-95	15%	1.4.1994	
1995-96	15%	1.4.1994	Note
1996-97	(a) 15%	1.4.1994	Note
	(b) 255%	1.4.1995	
<b>(II) Three-year funding method: second three-year funding cycle</b>			
1997-98	15%	1.4.1994	Note
1998-99	15%	1.4.1994	Note
1999-2000	(a) 15%	1.4.1994	Note
	(b) 255%	1.4.1998	
<b>(III) PAYG method</b>			
2000-01	(a) 15%	1.4.1994	Note
	(b) 85%	1.4.1999	
2001-02 and subsequent years	(a)	Provision for contract gratuities for existing posts for previous year adjusted according to price level adjustment factor	
	(b)	100% of contract gratuities for new posts created in RAE	

*Source: Audit's analysis based on LCS's records*

*Note: Subvention for 15% of the year's contract gratuities was provided based on the LCS's staff establishment as at 1.4.1994. For the new posts created in 1995-96, 15% of the year's contract gratuities were included in the normal funding to the LCC. However, 100%, instead of 15%, of the year's contract gratuities were provided for new posts created after 1995-96 (see para. 4.3(a)(ii) above). The inclusion of 100% of the year's contract gratuities in the normal funding to the LCC for new posts created during the period 1996-97 to 1998-99 had resulted in the over-provision of subvention to the LCC (see Table 4 and paras. 4.6 to 4.12 below).*



### **New posts created during the period 1996-97 to 1998-99**

4.5 During the period 1996-97 to 1998-99, the LCC obtained government subvention to create 28 new posts (see Appendix C) to enhance its work in the following areas:

- (a) legal, library, public information, research and simultaneous interpretation services;
- (b) administration of LegCo Members' remuneration and allowances;
- (c) secretariat support for committees of the LegCo;
- (d) production of the Hansard; and
- (e) development and operation of computer systems.

### **Contract gratuities for new posts created during the period 1996-97 to 1998-99**

4.6 Table 4 below summarises the percentages of the annual contract gratuities included in the subvention to the LCC for the new posts created during the period 1996-97 to 1998-99. It shows that most of the percentages of actual provision were much higher than those which should have been provided. **As a result, in most of the years subsequent to 1996-97, the subvention for contract gratuities had been over-provided by 85% per year for such new posts (see paras. 4.7 to 4.11 below).**

**Table 4**

**Subvention for contract gratuities  
for new posts created during the period 1996-97 to 1998-99**

**Percentage of annual contract gratuities**

Year	For new posts created in 1996-97		For new posts created in 1997-98		For new posts created in 1998-99	
	That should have been provided	Actually provided	That should have been provided	Actually provided	That should have been provided	Actually provided
1997-98	15%	100%	15%	100%	–	–
1998-99	15%	100%	15%	100%	15%	100%
1999-2000	15% plus 255%	100% plus 255%	15% plus 255%	100% plus 255%	15% plus 170% (Note)	100% plus 255%
2000-01	15% plus 85%	100% plus 85%	15% plus 85%	100% plus 85%	15% plus 85%	100% plus 85%
2001-02	15% plus 85%	100% plus 85%	15% plus 85%	100% plus 85%	15% plus 85%	100% plus 85%
2002-03	15% plus 85%	100% plus 85%	15% plus 85%	100% plus 85%	15% plus 85%	100% plus 85%

Source: *Audit's analysis based on LCS's records*

Note: *These new posts were created in the second year of the three-year funding cycle (1997-98 to 1999-2000). Therefore, the percentage of contract gratuities that should have been provided was 85% for two years in addition to 15%.*

## **Over-provision of subvention for contract gratuities for new posts created in 1996-97**

4.7 ***Subvention for 1996-97.*** For this year, there was no over-provision of subvention for contract gratuities.

4.8 ***Subvention for 1997-98 and 1998-99.*** The years 1997-98 and 1998-99 were the first and second years respectively of the second three-year funding cycle (1997-98 to 1999-2000). However, for the new posts created in 1996-97, the contract gratuities included in the normal funding to the LCC had not been reduced to 15% of the year's contract gratuities required under the three-year funding method. As a result, instead of 15%, 100% of the year's contract gratuities were provided each in 1997-98 and 1998-99 (see Table 4 in para. 4.6 above). This was essentially a calculation error, resulting in the over-provision of subvention for contract gratuities.

4.9 ***Subvention for 1999-2000.*** In 1999-2000, which was the third year of the second three-year funding cycle (1997-98 to 1999-2000), the LCS calculated the subvention required for contract gratuities, according to the three-year funding method, by adding 255% (85% per year  $\times$  3 years) of the contract gratuities for the three years from 1997-98 to 1999-2000 to the 15% already included in the normal funding (15% plus 255% — see para. 4.3 above). The LCS's calculation included the new posts created in 1996-97. However, for such new posts, the contract gratuities included in the normal funding to the LCC had not been reduced to 15% of the year's contract gratuities required under the three-year funding method (see para. 4.8 above). As a result, instead of 15% plus 255%, 100% plus 255% of the year's contract gratuities had been included in the subvention to the LCC (see Table 4 in para. 4.6 above). This was essentially a calculation error, resulting in the over-provision of subvention for contract gratuities.

4.10 ***Subvention for the years 2000-01 to 2002-03.*** For the years 2000-01 to 2002-03, the LCS used the PAYG method to calculate the subvention for contract gratuities: full funding for contract gratuities to be incurred in a year would be provided to the LCC in that year. As the normal funding had already included 15% of the contract gratuities for its staff, the LCS calculated 85% of the year's contract gratuities and added the amount to the subvention to arrive at the full funding (15% plus 85%) for contract gratuities to be incurred. The LCS's calculation included the new posts created in 1996-97. However, for such new posts, the contract gratuities included in the normal funding to the LCC had not been reduced to 15% of the year's contract gratuities required under the three-year funding method (see para. 4.8 above). As a result, the provision included in the subvention for each of the years 2000-01 to 2002-03 was 100% plus 85% of the year's contract gratuities, instead of 15% plus 85% (see Table 4 in para. 4.6 above). This was essentially a calculation error, resulting in the over-provision of subvention for contract gratuities.

### **Over-provision of subvention for contract gratuities for new posts created in 1997-98 and 1998-99**

4.11 Similarly, for the new posts created in each of the years 1997-98 and 1998-99, instead of 15%, 100% of the year's contract gratuities were included in the normal funding to the LCC. As a result, the subvention for contract gratuities for new posts created in 1997-98 was over-provided each year by 85%. For new posts created in 1998-99, the subvention for contract gratuities was over-provided by 85% in 1998-99, by 85% plus 85% in 1999-2000 and by 85% in subsequent years (see Table 4 in para. 4.6 above).

### **Contract gratuities actually provided exceeded the required levels**

4.12 It can be seen from Table 4 in paragraph 4.6 above that the contract gratuities for the new posts created during the period 1996-97 to 1998-99 had been over-provided because:

- (a) ***for the years 1997-98 and 1998-99 (the first and second years respectively of the second three-year funding cycle)***, instead of 15%, 100% of the annual contract gratuities were provided to the LCC each year;
- (b) ***for the year 1999-2000 (the third year of the second three-year funding cycle)***, instead of 85% per year for 3 years in addition to 15% (15% plus 255%) of the annual contract gratuities for the posts created in 1996-97 and 1997-98 and 85% per year for 2 years in addition to 15% (15% plus 170%) of the annual contract gratuities for the posts created in 1998-99, 85% per year for 3 years in addition to 100% (100% plus 255%) of the annual contract gratuities were provided; and
- (c) ***for the three years from 2000-01 to 2002-03***, instead of 15% plus 85% of the annual contract gratuities according to the PAYG method, 100% plus 85% of the annual contract gratuities were provided each year.

4.13 No new posts were created in 1999-2000 and 2000-01. For the new posts created in or after 2001-02, the inclusion of 100% of the year's contract gratuities in the normal funding to the LCC did not lead to an over-provision of subvention. This was because, according to the PAYG method, 100% of the year's contract gratuities were/would be provided each year.

## **Contract gratuities for posts not filled by contract staff**

4.14 When the LCC was established in April 1994 to take over the work of the OCLC and the OMLEGCO, many posts of the LCS were filled on a secondment basis by civil servants who had been working for the OCLC and the OMLEGCO (see paras. 1.2 and 1.3 above). These civil servants, who were not entitled to contract gratuities, were gradually replaced in 1994-95 by contract staff employed by the LCS. Furthermore, on 1 April 1994, the LCS created 31 new posts. Many of these newly created posts were vacant for a period of time before they were filled by contract staff.

## **LCS did not pay contract gratuities for some posts**

4.15 The LCS needed to pay contract gratuities only for those posts filled by contract staff. For posts filled by civil servants on a secondment basis and vacant posts, the LCS did not have to pay contract gratuities. The number of posts in the LCS which were not filled by contract staff (made up of either posts filled by civil servants or vacant posts) during the period April 1994 to April 1995 is summarised in Appendix D. During this period, a large number of posts were either filled by civil servants or vacant. The LCS did not have to pay contract gratuities for these posts.

## **Audit observations on the subvention for contract gratuities for new posts and posts not filled by contract staff**

4.16 Audit's examination of the subvention to the LCC for contract gratuities revealed that for the new posts created during the period 1996-97 to 1998-99, the percentages of the annual contract gratuities included in the subvention to the LCC had been wrongly calculated and, in most cases, a double provision (i.e. additional 85% per year) for these posts had been made (see Table 4 in para. 4.6 and paras. 4.8 to 4.11 above). **Audit has estimated that as a result of these calculation errors, the subvention to the LCC during the period 1997-98 to 2002-03 for contract gratuities for the new posts created during the period 1996-97 to 1998-99 had been over-provided by \$15.3 million (see Appendix E). Audit considers that the FSTB should have provided subvention to the LCC for contract gratuities for such new posts according to the appropriate percentages.**

4.17 Audit found that, in May 1995, in the LCS's funding request covering the three-year funding cycle 1994-95 to 1996-97 submitted to the FSTB for contract gratuities for 1996-97, the LCS's calculation was based on its staff establishment, which included all those posts not filled by contract staff during the period April 1994 to April 1995. The FSTB provided subvention to the LCC according to the LCS's calculation. **As a result, the LCC had been over-provided with subvention for contract gratuities in the first three-year funding cycle (1994-95 to 1996-97) because of the large number of posts not filled by contract staff during the period April 1994 to April 1995 (see Appendix D). Audit has estimated that government subvention to**

**the LCC included contract gratuities of \$5.1 million, which were not required. Audit considers that the FSTB should not have provided subvention to the LCC for contract gratuities for those posts which were not filled by contract staff.**

4.18 Audit examined the EOL to ascertain whether it was possible for the FSTB to require the LCC to refund to the Government the subvention over-provided to the LCC for contract gratuities for the new posts created during the period 1996-97 to 1998-99 and posts not filled by contract staff, or to make an equivalent reduction in the 2003-04 recurrent subvention to the LCC in order to recoup the subvention for contract gratuities over-provided. **As mentioned in paragraph 3.12 above, according to the EOL, there was no provision which enabled the Government to do so. In Audit's view, the Administration needs to consider amending the EOL to include a provision to recoup the over-provision.**

### **LCC's comments on the audit observations**

4.19 In January 2003, Audit sought the LCC's views on Audit's observations mentioned in paragraphs 4.16 to 4.17 above. In response, in February and March 2003, the LCC informed Audit that:

- (a) it must be reiterated that money provided to the LCC under the one-line vote arrangement was not segregated and earmarked for salaries, cash allowance or contract gratuities. The calculations of the LCC's subvention requirements were done entirely according to the mechanism for the funding of contract gratuities agreed with the Administration. Besides, since the LCC had full authority to deploy its resources, it had never been the requirement of the FSTB to track the creation, deletion or filling of posts for the purpose of calculating the 255% (85% per year  $\times$  3 years) of the year's contract gratuities for the third year of the three-year funding cycle (see audit views in para. 4.20(a) below);
- (b) for cash-flow reasons, provision of funds was made on the basis that 15% of the year's contract gratuities were provided in the normal funding of each year, and the remaining 255% (85% per year  $\times$  3 years) were provided in the third year of each three-year funding cycle, according to the establishment and projected salaries of the second year of each cycle. The actual staff establishment and the contract gratuities incurred in the first year and the third year of each cycle were not factors employed for projecting the 255% contract gratuities funding requirements. However, Audit had interpreted that, in the third year of each three-year funding cycle, the posts created in the first year would be provided with the balance contract gratuities of 255% (85% per year  $\times$  3 years), while the posts created in the second year and the third year would be provided with 170% (85% per year  $\times$  2 years) and 85% respectively. Audit's interpretation would require the tracking of each and every post, in order to work out the actual provision required. This

was contrary to the rationale of establishing a one-line vote for the LCC (see **audit views in para. 4.20(b) below**);

- (c) on the bidding of funds in an RAE, bids had always been calculated at 100% of the annual contract gratuities to reflect the full financial implications. Including 15% of the annual contract gratuities in the bids as suggested by Audit would be misleading (see **audit views in para. 4.20(c) below**);
- (d) the contract gratuities applied for 1996-97 were calculated according to the funding method mutually agreed between the FSTB and the LCC. If the posts filled by civil servants in 1994-95 were not taken into account when the LCS applied for the funding of contract gratuities for 1996-97, as suggested by Audit, the LCS would have to track all its posts to determine which one was filled by a civil servant or which one was left vacant for one reason or another. This would defeat the purpose of adopting the one-line vote arrangement for the LCC (see **audit views in para. 4.20(d) below**); and
- (e) on the question of refunding to the Government the over-provision of subvention for contract gratuities for the new posts created during the period 1996-97 to 1998-99 and posts not filled by contract staff, the LCC did not consider it acceptable to make any refund to the Government, for the reasons mentioned in paragraph 3.13(c) above (see **audit views in para. 4.20(e) below**).

#### **Audit views on LCC's comments**

4.20 In the light of the LCC's views mentioned in paragraph 4.19 above, Audit has the following views:

- (a) **under the one-line vote arrangement, there should be a basic control over the actual subvention requirements at the inception of the arrangement and at times when there are significant changes in circumstances (see para. 3.14(a) above). Audit notes that subvention is provided to the LCC in accordance with the one-line vote arrangement. Under normal circumstances, the LCC may not need to segregate and earmark money for different expenditure items. However, when there are significant changes in circumstances, the subvention requirements must be assessed accurately. The creation of new posts and the secondment of civil servants to the LCS were such changes. At these times, the actual subvention requirements for contract gratuities should have been calculated accurately.** Audit evidence shows that the over-provision of subvention for contract gratuities arose from the LCS's failure to use the correct percentages in the calculation of the LCC's subvention requirements. This resulted in the over-provision of subvention for contract gratuities of 85% per year (in most of the years subsequent to 1996-97) for the new posts created in the years 1996-97 to 1998-99. The

LCS' s failure to exclude in the calculation of the LCC' s subvention requirements for those posts not filled by contract staff during the period April 1994 to April 1995 had also resulted in the over-provision of subvention for contract gratuities;

- (b) the over-provision arose essentially from calculation errors. A double provision (i.e. additional 85% per year) had been made in most cases for the subvention for contract gratuities for the new posts created during the period 1996-97 to 1998-99. **As the LCC did not, in fact, incur contract gratuity payments for the over-provided portion of the subvention, allowing such a practice under the one-line vote arrangement would lead to the over-provision of subvention to the LCC;**
- (c) after a bid for new posts had been approved, the LCS should have adjusted the amount of new resources so that the normal funding to the LCC included the percentage of the annual contract gratuities adopted by the three-year funding method. **The LCS's failure to do so had resulted in the over-provision of subvention for contract gratuities for the new posts. This is because, notwithstanding that full funding for contract gratuities for the new posts had already been included in the normal funding, the LCS subsequently made a double request for the funding for 85% of contract gratuities per year for such posts;**
- (d) it is unacceptable for the LCS to have included contract gratuities for the posts not filled by contract staff for the period April 1994 to April 1995 when the LCS calculated the subvention requirements for contract gratuities in May 1995. This is because this expenditure had not been incurred by the LCC; and
- (e) Audit has identified the over-provision totalling \$20.4 million (\$15.3 million + \$5.1 million) for contract gratuities, which is not a genuine saving achieved by the LCC, as it has claimed (see para. 6.8 below). **The problem of over-provision needs to be addressed because the over-provision of the subvention for contract gratuities for those new posts will continue year after year, leading to the unjustified building up of the LCC's reserve.**

#### **Audit recommendations on the subvention for contract gratuities for new posts and posts not filled by contract staff**

4.21 Audit has ***recommended*** that the Secretary for Financial Services and the Treasury should:



- (a) **take prompt action to reduce the subvention to the LCC for 2003-04 in order to rectify the over-provision of subvention for contract gratuities for the new posts created during the period 1996-97 to 1998-99; and**
- (b) **consider amending the EOL to include a provision that the Administration may recoup the over-provision of subvention for contract gratuities by way of an adjustment to the subvention in subsequent years.**

### **Response from the Administration**

4.22 The Secretary for Financial Services and the Treasury has said that:

- (a) there are many methods of making a projection of the required subvention. The Administration and the LCC have agreed to the three-year funding method as it is a broadbrush and relatively simple approach to providing subvention for contract gratuities to the LCC, instead of going into details to calculate the subvention for contract gratuities required based on the latest establishment every year. Starting from 2000-01, the funding method has been changed to the PAYG method, which is a broadbrush funding arrangement even simpler than the three-year funding method. This new method enables the LCC to have a more stable income to plan for its deployment of resources (**see audit views in para. 4.23(a) below**);
- (b) the FSTB considers it justifiable to use 100% of the year's contract gratuities as a reference to calculate the resources required to support new or improved services. The LCC is free to deploy new resources under RAEs. For example, the LCC may use the new resources to contract out the services, instead of creating posts to provide the services. Audit's proposed method could be cumbersome in practice and does not conform with the funding method adopted by the FSTB. The proposed method will require the LCC and the FSTB to track the actual creation of such posts. The FSTB does not consider that the FSTB should micro-manage the subvention to the LCC. The FSTB considers that the LCC is in a better position to determine its own staff recruitment plan (**see audit views in para. 4.23(b) below**); and
- (c) the year 1994-95 was the first year after the LCC's establishment. The inclusion of the subvention for contract gratuities was an estimate based on the agreed staff establishment (i.e. 280). At that time, it was understood that the LCC would replace seconded civil servants by contract staff as soon as possible. It was difficult to estimate accurately when these seconded staff would be replaced and to calculate the required contract gratuities. To do so would also be inconsistent with the one-line vote arrangement (**see audit views in para. 4.23(c) below**).

## **Audit views on the response from the Administration**

4.23 In response to the comments made by the Secretary for Financial Services and the Treasury in paragraph 4.22 above, Audit has the following views:

- (a) **one basic control in any funding system (particularly for organisations which receive their funding solely from the Government), including the one-line vote arrangement, is a control over the actual subvention requirements at the inception of the arrangement and at times when there are significant changes in circumstances (see para. 3.14(a) above). The FSTB failed to exercise the basic funding control by ascertaining the actual subvention requirements for the changed circumstances i.e. the creation of new posts and the replacement of civil servants working in the LCS by contract staff.** The failure had resulted in the over-provision of subvention for contract gratuities for the new posts created during the period 1996-97 and 1998-99 and for the posts not filled by contract staff during the period April 1994 to April 1995. There is a need for the FSTB to adjust the annual subvention to rectify the over-provision;
  
- (b) **as full funding for contract gratuities had already been included in the normal funding to the LCC for the new posts created during the period 1996-97 to 1998-99, the LCS's subsequent funding requests for 85% of contract gratuities per year for such new posts clearly resulted in the over-provision of subvention to the LCC.** Therefore, the LCS should have reduced the contract gratuities included in the new resources for such new posts to 15% of the year's contract gratuities to avoid over-provision, as it had done for the new posts created in 1995-96; and
  
- (c) at the time of the LCS's funding request in May 1995 for 255% of the year's contract gratuities for the period April 1994 to March 1997, it was clearly known to both the LCC and the FSTB that a large number of posts were not filled by contract staff during the period April 1994 to April 1995.

## **PART 5: CONTRACT GRATUITIES PROVIDED TO NON-PROFESSIONAL AND SUPPORTING STAFF**

5.1 This PART examines the level of contract gratuities provided to non-professional and supporting staff of the LCS and suggests measures for improvement.

### **FSTB's guidelines on contract gratuities**

5.2 In May 1999, to take account of the prevailing employment market conditions, the FSTB issued Finance Bureau Circular Memorandum (FBCM) No. 10/99 promulgating a new set of guidelines on the provision of contract gratuities to staff employed on contract terms by subvented organisations. In this memorandum, the FSTB stated that:

- (a) the Government's subvention policy required that the terms and conditions of service of staff in subvented organisations should not be superior to those provided by the Government to comparable grades in the civil service;
- (b) **the level of contract gratuities offered to civil service staff employed on agreement terms was determined, having regard to the recruitment situations of the grade and the competitiveness of the remuneration package;**
- (c) **in the light of the employment market situations, subvented organisations should provide contract gratuities to:**
  - (i) **professional staff (Note 5) employed on gratuity-bearing terms at a level of no more than 15% of their basic salary; and**
  - (ii) **non-professional and supporting staff (Note 5) at a level of no more than 10% of their basic salary;**
- (d) these gratuity levels should apply to new appointments. For the renewal of existing contracts, in line with the civil service's practice, subvented organisations might continue

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**Note 5:** *Professional staff refer to those staff employed to perform functions requiring skills in managerial, professional, technical or other specialised fields. Non-professional and supporting staff refer to those staff employed to perform functions which do not require such skills.*

to offer the level of contract gratuities, as in the previous contracts, subject to the condition that it would not exceed 25% of the total basic salary during the contract period; and

- (e) **where Controlling Officers supported individual cases of appointment in subvented organisations providing contract gratuities at a level higher than the prescribed levels, they should seek the FSTB's prior agreement in the light of the financial implications involved.**

### **Contract gratuities offered to staff of the LCS higher than the prescribed level**

5.3 Before June 1999, the LCS offered contract gratuities to all its contract staff at a level of 25% of their basic salary. In June 1999, the LCS followed the new guidelines and reduced the level of contract gratuities of its newly recruited professional staff to 15% of their basic salary. For its newly recruited non-professional and supporting staff, the LCS offered contract gratuities at a level of 10% of their basic salary, subject to the provision that the level might be adjusted in the light of the results of its review on contract gratuities which was being conducted. For the renewal of existing contracts, the LCS continued to offer the same level of contract gratuities (i.e. 25% of the basic salary) as in the existing contracts.

5.4 In April 2000, the LCC completed its review on contract gratuities and increased the level of contract gratuities for non-professional and supporting staff of the LCS recruited since June 1999 to a level of 15% of their basic salary (see para. 5.3 above). Since then, the LCS has offered contract gratuities to all new appointees at a level of 15% of their basic salary.

5.5 In the LegCo Paper No. LCC 34/99-00 on the "Review of Contract Gratuity for Staff of the Legislative Council Secretariat", it was stated that a flat rate of contract gratuities at 15% should be offered to new appointees of all posts/ranks on the following grounds:

- (a) the terms and conditions of service of all staff of the LCS, irrespective of their ranks, should be compared with those of civil servants on pensionable terms because staff of the LCS, though employed on contract terms, were de facto permanent staff;
- (b) the difference in the level of responsibilities between "skilled" and "non-skilled" jobs had already been reflected in the difference in the level of their salaries. It was unreasonable and unfair to further aggravate the difference in the rate of contract gratuities;

- (c) the difference in the level of contract gratuities between “skilled” and “non-skilled” jobs was divisive and not conducive to staff morale;
- (d) contract gratuity was, in effect, pro-rata pension. As across-the-board pension factors were applied to eligible staff, so should the rate of contract gratuities; and
- (e) with the implementation of the Mandatory Provident Fund (MPF) Scheme at the end of 2000, the Government had decided that the monthly contribution of 5% of basic salary from the employer would be offset by deduction of the same amount from the contract gratuities payable to staff of the LCS. This deduction, coupled with their own 5% monthly contribution for MPF, meant that junior staff would receive practically no contract gratuities if their contract gratuities would be set at 10% of their basic salary, as proposed. Such arrangements were challenged as indirect exploitation of employees.

5.6 Based on the assumption that all existing staff of the LCS were replaced by new appointees and were on the maximum point of their salary scale, the LCS estimated that, if all these staff were paid contract gratuities at 15% of their basic salary irrespective of their rank, the additional amount of contract gratuities payable by the LCS was \$1.3 million per annum. For the period June 1999 to March 2002, the additional amount of contract gratuities actually incurred by the LCS was \$102,000.

### **Contract gratuities for officers on civil service agreement terms**

5.7 Before July 2002, the approval of the Civil Service Bureau (CSB) was needed for contract gratuity levels offered for appointments on civil service agreement terms. In June 2002, the CSB announced in CSB Circular No. 9/2002 that HoDs and Heads of Grade (HoGs) might approve contract gratuity levels not exceeding 15% of the basic salary. In this circular, the CSB stated that HoDs and HoGs should take the following two factors into account in deciding the contract gratuity levels for individual appointments:

- (a) ***Skill level of the job.*** An office that required a high level of academic attainments, professional and/or specialist skills, or experience might justify a higher level of contract gratuities to attract talents of the necessary calibre; and
- (b) ***Recruitment conditions.*** An office might require a higher level of contract gratuities to attract suitable candidates, if it faced keen competition from other employers in the market for talents of the necessary calibre or when the target pool of candidates was small.

## **Audit observations on contract gratuities provided to non-professional and supporting staff**

5.8 According to the guidelines on the provision of contract gratuities to staff employed on contract terms by subvented organisations stipulated in FBCM No. 10/99, in view of the financial implications, Controlling Officers should seek the FSTB's prior agreement if they offer to non-professional and supporting staff contract gratuities of more than 10% of the basic salary (see para. 5.2(e) above). **However, Audit noted that as the Controlling Officer, the Secretary General of the LCS had not sought the FSTB's prior agreement on offering contract gratuities to its newly recruited non-professional and supporting staff at a level of 15% of their basic salary. In July 2001, Audit wrote to the LCS, suggesting that the LCS should rectify this irregularity by seeking the covering approval from the FSTB and should follow the FSTB's guidelines in future.** In July 2001, in response to Audit's suggestion, the LCS wrote to the FSTB, requesting the FSTB to acknowledge the autonomy of the LCC in offering a higher level of contract gratuities to its newly recruited non-professional and supporting staff of the LCS.

5.9 In June 2002, the FSTB replied to the LCS, saying that the LCS should:

- (a) follow the FSTB's guidelines on offering contract gratuities unless there were very strong justifications, such as recruitment difficulties; and
- (b) seek the FSTB's approval if the LCS offered contract gratuities at a level higher than the prescribed levels.

5.10 In early July 2002, the LCS replied to the FSTB that in its view, the LCS did not need to seek the FSTB's prior agreement on offering contract gratuities to newly recruited non-professional and supporting staff at a level of 15% of their basic salary. This was because, the LCCO, which took precedence over the Government's subvention policy (see para. 5.2(a) above), had conferred the discretionary powers upon the LCC to deal with matters on the terms and conditions of service of staff of the LCS as long as the terms and conditions of service were broadly in line with those applicable to persons employed in the civil service. The LCS's view was based on section 10(2) of the LCCO, which stipulated that the LCC should ensure that the grading, remuneration and other terms and conditions of service of staff of the LCS were kept, subject to the LCC's discretion to make exceptions in such cases as it saw fit, broadly in line with those applicable to persons employed in the civil service.

5.11 In late July 2002, the FSTB advised the LCS that:

- (a) in providing subvention to an organisation, the Government required the organisation to comply with the Government's subvention policy that the terms and conditions of service of subvented staff should be no better than those of comparable civil service ranks (see para. 5.2(a) above); and
- (b) in the light of CSB Circular No. 9/2002 which allowed HoDs and HoGs to approve contract gratuity levels of not exceeding 15% of the basic salary for officers (see para. 5.7 above), the FSTB was reviewing the arrangement for staff employed in subvented organisations.

### **LCC's comments on the audit observations**

5.12 In January 2003, Audit sought the LCC's views on whether it would review the justifications for offering contract gratuities at 15% of the basic salary, instead of no more than 10%, to newly recruited non-professional and supporting staff of the LCS, having regard to the employment market situations. In February 2003, the LCC noted Audit's suggestion that it should conduct such a review. In response, the LCC informed Audit that:

- (a) the LCC was given a status independent of the Government and was empowered, to act in all financial and administrative matters relating to the provision of support services for the LegCo. According to section 17 of the LCCO, the LCC should not, in relation to the formulation and execution of managerial and financial policies of it or the LCS, be subject to any direction or control of any person except that of the LegCo. The LCC was given the power to determine the terms and conditions of staff employed by it under section 10 of the LCCO, subject to the requirement that the terms and conditions so determined were kept broadly in line with those applicable to persons employed in the civil service, with the LCC being given the discretion to make exceptions in such cases as it saw fit. The LCC's decision made on 13 April 2000 was a policy decision made, after having considered the changes in the terms and conditions of service of civil servants notified to the Secretary General of the LCS through FBCM No. 10/99 and the proposals made by the Secretary General in the LegCo Paper No. LCC 34/99-00. The Legal Adviser of the LCS was of the view that section 10(2) of the LCCO provided the legal authority for the LCC to make that decision (see audit views in para. 5.13 below); and
- (b) in the view of the Legal Adviser of the LCS, FBCM No. 10/99 did not impose an obligation on the LCC or the Secretary General of the LCS to seek prior approval of the then Secretary for the Treasury before the LCC made its decision on 13 April 2000. Neither did the EOL impose such an obligation because the LCC was given the discretion to spend its reserve on condition that an expenditure so incurred did not create a commitment on government funds (see audit views in para. 5.13 below).

## **Audit views on LCC's comments**

5.13 Audit notes the LCC's view that the LCC is given the power to determine the terms and conditions of staff employed by it, as mentioned in paragraph 5.12(a) and (b) above. However, as stated in FBCM No. 10/99, the levels of contract gratuities were determined having regard to the employment market situations (see para. 5.2 above). In CSB Circular No. 9/2002, it was further pointed out that the two factors of skill level of the job and recruitment conditions should be taken into account in deciding the contract gratuity levels for individual appointments (see para. 5.7 above). **Audit considers that the LCC did not have strong justifications, based on the prevailing employment market situations, for supporting its decision to offer non-professional and supporting staff contract gratuities at a level of 15% of their basic salary, instead of no more than 10% as stipulated in the FSTB's guidelines in FBCM No. 10/99. The LCC's non-compliance with the Government's guidelines on providing contract gratuities to non-professional and supporting staff is at variance with the Government's best management practice. The FSTB needs to seek legal advice as to whether the LCC is empowered to offer contract gratuities to staff of the LCS at a level higher than that prescribed by the FSTB, without seeking the FSTB's prior agreement. In any event, to enhance public accountability, the LCC should adopt the Government's best management practice (i.e. no more than 10% for such staff).**

## **Audit recommendations on contract gratuities provided to non-professional and supporting staff**

5.14 Audit has ***recommended*** that the Secretary for Financial Services and the Treasury should seek the Department of Justice's advice as to whether the LCCO has conferred discretionary powers on the LCC to offer contract gratuities to staff of the LCS at a level higher than that prescribed by the FSTB, without seeking the FSTB's prior agreement. In any event, to enhance public accountability, the FSTB should urge the LCC to adopt the Government's best management practice (i.e. no more than 10% for non-professional and supporting staff).

## **Response from the Administration**

5.15 The Secretary for Financial Services and the Treasury has said that:

- (a) the FSTB has expressed its view to the LCC that, in accordance with FBCM No. 10/99, the LCC should seek the FSTB's prior agreement on offering contract gratuities to newly recruited non-professional and supporting staff at a level of 15% of their basic salary; and
- (b) the FSTB is seeking legal advice, as recommended by Audit.



## **PART 6: RESERVE OF THE LCC**

6.1 This PART examines the level of reserve of the LCC and suggests measures for improvement.

### **Recurrent account subheads of the LCC**

6.2 As mentioned in paragraph 1.13 above, the recurrent expenditure of the LCC is provided under two recurrent account subheads under Head 112 in the Estimates, namely:

- (a) ***Subhead 366 for remuneration and reimbursements for LegCo Members.*** This subhead is subject to conventional expenditure control. The rates of LegCo Members' remuneration and reimbursements are proposed by the Government and approved by the FC. Under the delegated authority of the FC, the rates are adjusted by the Government annually in October according to the movement of Consumer Price Index (C) (Note 6). If the provision of the subhead is insufficient to meet the requirement as a result of the adjustment of rates, supplementary provision, if sought by the LCC, may be approved by the Government to meet the shortfall; and
- (b) ***Subhead 367 for staff emoluments and general expenses of the LCC.*** This subhead is operated as a one-line vote and on a cash-limited budget. There are no pre-determined provisions under individual conventional expenditure subheads (such as expenditure on salaries, allowances, hire of service, contract maintenance and general departmental expenses). Within the global budget for operational expenses, the Secretary General of the LCS is given autonomy and flexibility in deploying the funds between the various categories, components and items of expenditure to suit the LCC's needs and changing circumstances.

### **Maximum level of reserve not set**

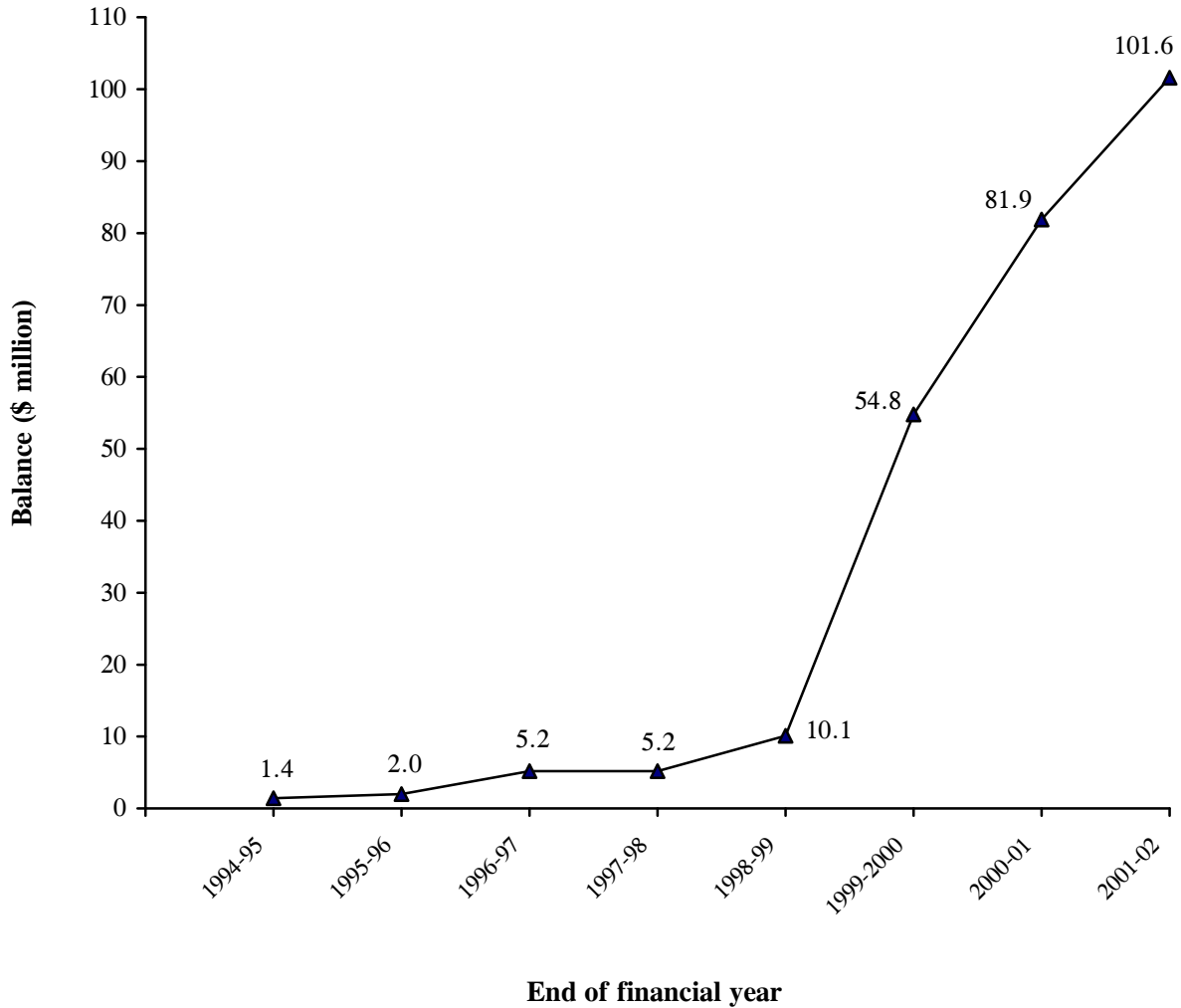
6.3 Surpluses of government subvention for staff emoluments and general expenses under Subhead 367 may be credited to the LCC's Operating Reserve Account for future use. The balance of this account for the period 1994-95 to 2001-02 is shown in Figure 2 below. As at 31 March 2002, the balance of this account was \$101.6 million, which is 41% of the subvention for staff emoluments and general expenses of \$246.6 million for 2002-03.

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**Note 6:** *The Consumer Price Index (C) is compiled by the Census and Statistics Department to reflect the impact of consumer price changes on households in the relatively high monthly expenditure range of \$31,800 to \$64,600.*

**Figure 2**

**Balance of the Operating Reserve Account for the period 1994-95 to 2001-02**



Source: LCS's records

Note: The balance of the Operating Reserve Account at the end of each financial year might be less than the cumulative amount of excess subvention provided to the LCC because of the time lag in transferring the excess subvention to the Operating Reserve Account.

6.4 According to the Guidelines on the Management and Control of Government Subventions, subject to the FSTB's agreement and the provisions of relevant legislation, a subvented organisation may carry a contingency reserve. A subvented organisation which considers that it needs to carry a reserve must justify the amount of reserve it needs and the intended purposes of the reserve. If, at the end of a financial year, the level of reserve exceeds the approved level, the excess amount will be netted off in the following financial year's subvention. The level of reserve, if any, will be subject to the approval of the Legislature in the context of the draft Estimates. **However, Audit notes that the maximum level of reserve of the LCC has not been mentioned in the EOL.**

#### **Audit observations on reserve of the LCC**

6.5 In PARTs 3 and 4 above, Audit has found that the subvention to the LCC for staff emoluments for the period 1994-95 to 2002-03 has been over-provided by \$50.9 million (see also Table 5 below).

**Table 5**

**Over-provision of subvention for staff emoluments  
for the period 1994-95 to 2002-03**

<b>Subvention</b>	<b>Period of over-provision</b>	<b>Over-provision (\$ million)</b>
Cash allowance (see para. 3.10)	1994-95 to 2002-03	30.5
Contract gratuities for new posts (see para. 4.16)	1997-98 to 2002-03	15.3
Contract gratuities for posts not filled by contract staff (see para. 4.17)	April 1994 to April 1995	5.1
	<b>Total</b>	<b><u>50.9</u></b>

*Source: Audit's computation based on LCS's records*

6.6 According to the EOL between the Administration and the LCC, any surplus of income over expenditure at the end of a financial year may be kept in the reserve of the LCC. Hence, the above over-provision of subvention amounting to \$50.9 million has contributed to the significant increase in the reserve of the LCC (see Figure 2 in para. 6.3 above).

6.7 Audit's review has revealed that, according to the EOL, there is no provision which enables the Government to require the LCC to refund to the Government the over-provision of subvention to the LCC mentioned in paragraph 6.5 above or to make an equivalent reduction in the 2003-04 recurrent subvention to the LCC in order to recoup the subvention over-provided (see paras. 3.12 and 4.18 above). According to the EOL, the reserve may be spent at the discretion of the LCC. Furthermore, the LCC will continue to accumulate additional reserve as long as it has surplus income over expenditure at the end of a financial year.

### **LCC's comments on the audit observations**

6.8 In January 2003, Audit sought the LCC's views on setting a maximum level of reserve which the LCC would be allowed to keep, having regard to its operating needs for, and the past spending pattern of, the subvention for staff emoluments and general expenses. In response, in February 2003, the LCC informed Audit that the LCC's surpluses had been accumulated over the past nine years through its prudent management of funds under the one-line vote arrangement, which promoted a sense of ownership and flexibility in optimal utilisation of funds. The LCC considered that it would be inconsistent with the rationale of the one-line vote arrangement adopted for the LCC if a maximum level was to be set for the LCC's reserve. The existing provisions in the EOL should remain unchanged (see **audit views in paras. 6.9 and 6.10 below**).

### **Audit views on LCC's comments**

6.9 Audit accepts that the main advantage of the one-line vote arrangement (as noted by the LegCo President's Working Group —see para. 1.8(b) above) is flexibility in the use of funds under the relevant subheads of expenditure. However, this arrangement has deficiencies if the provision of funds is not properly controlled, as illustrated in the present case. **Audit evidence has shown that due to the provision of government funds for expenditure which was actually not required by the LCC (see Table 5 in para. 6.5 above), there had been over-provisions of subvention under this one-line vote arrangement totalling \$50.9 million over the past nine years. The FSTB's failure to adjust the subvention, despite being aware of the decrease in the subvention requirements for cash allowance and the over-provision of subvention for contract gratuities, had led to the unjustified building up of the LCC's reserve.**

6.10 It is pertinent to note that for many subvented organisations (e.g. the Hospital Authority which has a 5% ceiling on the budgeted annual recurrent expenditure) receiving similar block grant funding, the Government has set different levels of maximum reserve, up to which such organisations are allowed to keep their unspent funds. **Audit considers that, in line with the Guidelines on the Management and Control of Government Subventions, the FSTB needs to set a maximum level of reserve which the LCC would be allowed to keep.** As mentioned in paragraph 6.2(a) above, any shortfall of meeting the remuneration and reimbursements for LegCo Members caused by the adjustment of rates of such expenditure may be met by the Government. Therefore, in setting the maximum level of reserve of the LCC, the Government only needs to consider the annual subvention requirements for staff emoluments and general expenses.

### **Audit recommendation on reserve of the LCC**

6.11 **Audit has recommended that the Secretary for Financial Services and the Treasury should consider setting a maximum level of reserve which the LCC would be allowed to keep, having regard to its operating needs for, and the past spending pattern of, the subvention for staff emoluments and general expenses.**

### **Response from the Administration**

6.12 The Secretary for Financial Services and the Treasury has said that:

- (a) given the governance that the LCC is subject to and the current level of the LCC's reserve, the FSTB does not think that there is imminent and practical need for setting a ceiling for the reserve (see audit views in para. 6.13 below); and
- (b) subject to the views of the LCC, the FSTB would not object to having such a ceiling.

### **Audit views on the response from the Administration**

6.13 Audit appreciates the FSTB's views on the governance that the LCC is subject to. However, in view of the rapid building up of the LCC's reserve from \$10.1 million to \$101.6 million during the last four financial years (see Figure 2 in para. 6.3 above) and the fact that many subvented organisations have ceilings on their reserves, there is a need for the FSTB to expedite its action in this matter.

Subvention for the period 1994-95 to 2002-03

Year	LegCo Members' remuneration and reimbursements	Staff emoluments and general expenses	Capital subvention	Total subvention
	(a)	(b)	(c)	(d) = (a)+(b)+(c)
	(\$ million)	(\$ million)	(\$ million)	(\$ million)
1994-95	78.5	123.0	7.6	209.1
1995-96	91.7	136.9	14.8	243.4
1996-97	107.8	214.7	21.4	343.9
1997-98	122.6	175.6	8.1	306.3
1998-99	112.6	198.5	17.9	329.0
1999-2000	122.2	286.5	13.3	422.0
2000-01	112.4	232.8	8.2	353.4
2001-02	120.7	248.8	6.2	375.7
2002-03	131.6	246.6	4.8	383.0
<b>Total</b>	<b><u>1,000.1</u></b>	<b><u>1,863.4</u></b>	<b><u>102.3</u></b>	<b><u>2,965.8</u></b>
<b>Percentage</b>	<b>34%</b>	<b>63%</b>	<b>3%</b>	<b>100%</b>

Source: LCS's records

**Appendix B**  
(para. 1.17 refers)

**Staff emoluments for the period 1994-95 to 2001-02**

<b>Year</b>	<b>Expenditure on staff emoluments</b>	<b>Total expenditure on staff emoluments and general expenses</b>	<b>Percentage</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c) = <math>\frac{(a)}{(b)} \times 100\%</math></b>
	<b>(\$ million)</b>	<b>(\$ million)</b>	
1994-95	109.7	122.5	89.6%
1995-96	121.7	137.3	88.6%
1996-97	177.2	198.8	89.1%
1997-98	166.8	188.9	88.3%
1998-99	178.4	200.7	88.9%
1999-2000	222.8	248.2	89.8%
2000-01	194.1	216.2	89.8%
2001-02	207.9	234.0	88.8%

*Source: LCS's records*

*Note: Expenditure for 2002-03 is not yet available.*

**Appendix C**  
(para. 4.5 refers)

**New posts created during the period 1996-97 to 1998-99**

<b>Year</b>	<b>Post title</b>	<b>Number of new posts</b>
1996-97	Accounting Clerk	2
	Interpreter	1
	Librarian	1
	Research Officer	3
	Translation Officer	1
	Typist	2
	<b>Subtotal</b>	
1997-98	Assistant Computer Officer	1
	Chief Translation Officer	1
	Clerical Officer I	3
	Clerical Officer II	3
	Senior Assistant Secretary	2
	Senior Translation Officer	1
	Typist	3
<b>Subtotal</b>		<b>14</b>
1998-99	Assistant Legal Adviser	1
	Clerical Officer II	1
	Information Technology Manager	1
	Public Information Officer	1
<b>Subtotal</b>		<b>4</b>
	<b>Total</b>	<b><u>28</u></b>

*Source: LCS's records*



**Appendix D**  
(paras. 4.15  
and 4.17 refer)

**Number of posts filled by civil servants or which were vacant  
during the period April 1994 to April 1995**

<b>As at</b>	<b>Number of posts filled by civil servants</b>	<b>Number of vacant posts (Note 1)</b>	<b>Total number of posts for which contract gratuities had not been paid (Note 2)</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c) = (a) + (b)</b>
1 April 1994	161	36	197
1 May 1994	154	40	194
1 June 1994	145	32	177
1 July 1994	137	33	170
1 August 1994	109	31	140
1 September 1994	100	27	127
1 October 1994	94	27	121
1 November 1994	84	23	107
1 December 1994	71	28	99
1 January 1995	57	26	83
1 February 1995	32	27	59
1 March 1995	22	27	49
1 April 1995	0	41	41

*Source: LCS's records*

*Note 1: These included existing vacant posts and newly created posts which were vacant.*

*Note 2: During this period, the average number of posts for which the LCS did not need to pay contract gratuities was 120, which represented 43% of its average establishment of 280.*

**Appendix E**  
(para. 4.16 refers)

**Over-provision of subvention for contract gratuities  
for new posts created during the period 1996-97 to 1998-99**

Year	Over-provision for 10 posts created in 1996-97	Over-provision for 14 posts created in 1997-98	Over-provision for 4 posts created in 1998-99	Total over-provision
	(a)	(b)	(c)	(d) = (a)+(b)+(c)
	(\$ million)	(\$ million)	(\$ million)	(\$ million)
1997-98	0.9	0.8	-	1.7
1998-99	1.0	1.1	0.5	2.6
1999-2000	1.0	1.1	1.0	3.1
2000-01	1.0	1.1	0.5	2.6
2001-02	1.0	1.1	0.5	2.6
2002-03	1.1	1.1	0.5	2.7
<b>Total</b>	<b><u>6.0</u></b>	<b><u>6.3</u></b>	<b><u>3.0</u></b>	<b><u>15.3</u></b>

*Source: Audit's computation based on LCS's records*

**Acronyms and abbreviations**

CAR	Cash allowance rate
CSB	Civil Service Bureau
EOL	Exchange of Letters
FAR	Financial and Accounting Regulation
FBCM	Finance Bureau Circular Memorandum
FC	Finance Committee
FSTB	Financial Services and the Treasury Bureau
HoD	Head of Department
HoG	Head of Grade
LCC	Legislative Council Commission
LCCO	Legislative Council Commission Ordinance
LCS	Legislative Council Secretariat
LegCo	Legislative Council
MPF	Mandatory Provident Fund
MPS	Master Pay Scale
OCLC	Office of the Clerk to the Legislative Council
OMLEGCO	Office of the Members of the Legislative Council
PAYG	Pay-as-you-go
PFO	Public Finance Ordinance
RAE	Resource Allocation Exercise
SAI	Standing Accounting Instruction