



審計署  
香港灣仔  
告士打道七號  
入境事務大樓  
二十六樓

Audit Commission  
26th Floor  
Immigration Tower  
7 Gloucester Road  
Wanchai, Hong Kong

電話 Telephone : 2829 4272

本署檔號 Our Ref. : UB/PAC/VFM/40

來函檔號 Your Ref. : CB(3)/PAC/R40

24 June 2003

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

Dear Ms HON,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 40)**

**Chapter 5: Subvention for staff emoluments  
of The Legislative Council Commission**

Thank you for your letter of 20 June 2003 seeking my comments (including proposed questions) on the letters from the Secretary for Financial Services and the Treasury and the Secretary General of the Legislative Council Secretariat.

I forwarded to you the proposed questions requested by the Public Accounts Committee on 21 June 2003.

My comments on the letters dated 17 and 19 June 2003 from the Secretary for Financial Services and the Treasury are set out in Appendixes I and II respectively. My comments on the letter dated 19 June 2003 from the Secretary General of the Legislative Council Secretariat are set out in Appendix III.

During the meeting of 20 June 2003, the Committee asked whether Audit would like to consolidate its views on the captioned subject so as to facilitate the Committee's deliberations. Audit's consolidated views are set out in Appendix IV.

A Chinese translation of this letter will be forwarded to you shortly.

Yours sincerely,

  
(Patrick K Y LEUNG)  
for Director of Audit

**Audit comments on the letter from  
the Secretary for Financial Services and the Treasury  
to the PAC dated 17 June 2003**

**Paragraph 3**

***FSTB's view***

The established funding arrangement for The Legislative Council Commission (the LCC) does not envisage the adjustment of government funding to reflect the LCC's actual expenditure on cash allowance.

***Audit comments***

*In March 2001, the Financial Services and the Treasury Bureau (FSTB) informed the LCC that, because of the adoption of a new set of lower cash allowance rates (CARs) for new recruits, government subvention to the LCC would be adjusted in the light of actual savings (which were anticipated to be small) achieved (see para. 3.6 of the Audit Report). Audit considers that this indicates that the established funding arrangement for the LCC does not rule out the need to adjust the government funding to reflect the LCC's actual expenditure on cash allowance. Any effective funding arrangement should allow for adjustments of funding when there are significant changes in circumstances.*

**Paragraph 4(i)**

***FSTB's view***

In adopting the one-line vote (OLV) arrangement, the Administration was conscious that the LCC had the autonomy and flexibility in deploying funds in the OLV among expenditure components, and was not subject to the Administration's control at the level of expenditure components.

*Audit comments*

*Audit appreciates the merits of flexibility in the deployment of resources under the OLV 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 (see Note 2 to para. 1.22 of the Audit Report). Audit notes that the LCC may not need to segregate and earmark money for different expenditure components. However, when there are significant changes in circumstances, the subvention requirements for individual expenditure components must be re-assessed. The creation of new posts and the secondment of civil servants to the Legislative Council Secretariat (LCS) were such changes. At these times, the actual subvention requirements for contract gratuities should have been calculated accurately (see para. 4.20(a) of the Audit Report). It would be contrary to the principle of prudent financial management if the OLV 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) for cash allowance. There is a need to establish an adjustment mechanism (see para. 3.17(b) of the Audit Report). 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 of the Audit Report), there had been over-provisions of subvention under the OLV 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 (see para. 6.9 of the Audit Report).*

**Paragraph 4(ii)**

*FSTB's view*

The FSTB did not provide additional subvention to the LCC when the CARs were revised upwards, nor reduced the subvention when the CARs were decreased.

*Audit comments*

*According to the Exchange of Letters (EOL), additional funds will be provided to the LCC to meet the cost of salaries and allowances in accordance with approved rates and scales (see para. 1.14(a) of the Audit Report). In fact, since the LCC's establishment in April 1994, its subvention requirements as reflected in the budget have never exceeded its subvention for cash allowance (see Table 1 in para 3.9 of the Audit Report).*

**Paragraph 5(i)**

***FSTB's view***

Taking 2002-03 as an example, the changes in CARs for Category I, II and III staff were -3.76%, -1.8% and +0.03% respectively. Assuming one-third of the LCS staff had their contracts renewed or were replaced by new recruits, the resultant savings would be \$0.746 million, which amounted to only 0.3% of the LCC's 2002-03 approved estimates of \$246.6 million for staff emoluments and general expenses.

***Audit comments***

*The cumulative effect of the decrease in CARs from 1994-95 to 2002-03 has led to an over-provision of \$4.8 million for 2002-03, representing 2% of the LCC's approved estimates for staff emoluments and general expenses for that year (see Table 2 in paragraph 3.10 of the Audit Report). The over-provision of subvention for cash allowance for the period 1994-95 to 2002-03 as a result of the significant decrease in CARs and some staff of the LCS having chosen not to receive cash allowance, amounted to \$30.5 million (see Table 1 in para. 3.9 of the Audit Report). The following table shows the over-provision as a percentage of the subvention for cash allowance for each year.*

**Percentage of over-provision of subvention for cash allowance  
for the period 1994-95 to 2002-03**

Year	Subvention	Over-provision	Percentage of over-provision
	(a)	(b)	(c) = $\frac{(b)}{(a)} \times 100\%$
	(\$ million)	(\$ million)	(%)
1994-95	19.5	—	—
1995-96	22.1	1.1	5.0%
1996-97	23.0	1.7	7.4%
1997-98	25.7	2.9	11.3%
1998-99	28.5	4.0	14.0%
1999-2000	29.6	5.5	18.6%
2000-01	29.6	5.3	17.9%
2001-02	30.7	4.6	15.0%
2002-03	31.7	5.4	17.0%
<b>Overall</b>	<b>240.4</b>	<b>30.5</b>	<b>12.7%</b>

*It can be seen in the above table that the over-provision has exceeded 10% of the subvention to the LCC for cash allowance since 1997-98 and has been 14% or more of such subvention since 1998-99. Audit considers that the resultant savings due to the cumulative decrease in CARs since 1994-95 are significant.*

**Paragraph 5(ii) and 5(iii)**

***FSTB's view***

If the FSTB were to reduce savings resulting from the decrease in CARs and having regard to the fact that some staff of the LCS chose not to receive cash allowance from the LCC's funding, the Government would have to keep track of the LCC's contract renewals, recruitment of new staff and the changes in personal situation of each staff. That would not be an OLV arrangement, and would involve the Government's detail monitoring of the LCC's contracts with staff.

***Audit comments***

*Audit evidence shows that the LCS has all the details of the reduction in subvention requirements for cash allowance due to the decrease in CARs and the fact that some staff of the LCS chose not to receive cash allowance. The actual subvention requirements for cash allowance are in fact reflected in the LCC's budget which includes breakdown of expenditure submitted to the FSTB every year (see Annex to the Appendix to the letter from the Director of Audit to the PAC dated 21 June 2003). The FSTB would not have over-provided funds to the LCC, if it had adjusted the subvention to the LCC for cash allowance according to the LCC's budget (see Table 1 in para. 3.9 of the Audit Report). As the LCS has full details of the actual subvention requirements for cash allowance and such details are submitted to the FSTB every year, there will not be any extra work for the LCS or the FSTB to keep track of the actual requirements for cash allowance.*

**Paragraph 5(iv)**

***FSTB's view***

The adjustment of funding to the LCC according to the actual expenditure on other expenditure components would defeat the purpose of having an OLV funding arrangement for the LCC.

***Audit comments***

*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 OLV arrangement (see para. 3.17(a) of the Audit Report). It would be contrary to the principle of prudent financial management if the OLV 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 (see para. 3.17(b) of the Audit Report).*

**Paragraph 6**

***FSTB's view***

The three-year funding method represented a broadbrush approach, using projected establishment as the basis for projecting the funding to be included for contract gratuities.

***Audit comments***

*Audit evidence shows that in May 1995, in accepting the funding requests submitted to the FSTB by the LCS for contract gratuities including the contract gratuities for posts not filled by contract staff during the period April 1994 to April 1995, the FSTB knew that the LCC did not need to pay contract gratuities for the large number of non-contract staff (see para. 4.23(c) and Appendix D of the Audit Report).*

## Paragraph 7

### *FSTB's view*

In line with the FSTB's general practice, for successful bids for resources by the LCC, the FSTB uses 100% of the year's contract gratuities as a reference to calculate the resources required for supporting the new services or improved services. Upon Resource Allocation Exercise (RAE) allocation, the LCC is free to deploy the resources supported in the most economical way as it sees fit so long as the services are provided as specified in the resource bid.

### *Audit comments*

*Audit wishes to point out that, 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 only 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 (see para. 4.20 (c) of the Audit Report). Furthermore, although upon RAE allocation, the LCC is free to deploy the resources supported in the most economical way as it sees fit, as indicated in the third paragraph in the letter from the then Secretary for the Treasury to the Secretary General of the LCS dated 23 August 1997 (on the 1997 RAE), the then Secretary for the Treasury stated that the Secretary General would not normally be allowed to repeat the request for funds for the same purpose in subsequent years (see the third paragraph of Appendix II to the letter from the Secretary General of the LCS to the PAC dated 19 June 2003).*

*Audit considers that, unless the amount of new resources for the new posts had been adjusted so that the normal funding to the LCC included only the percentage (i.e. 15%) of the annual contract gratuities adopted by the three-year funding method, the double request for the funding for 85% of contract gratuities per year for the new posts is a duplication of the request for funds for the same purpose. This has in fact breached the Secretary's condition of approval of new resources for the new posts.*



**Paragraph 8**

***FSTB's view***

Under the three-year funding method, there was no need to adjust the funding for contract gratuities to the LCC to reflect changes in actual requirements.

***Audit comments***

*Audit considers that the funding to the LCC for contract gratuities had exceeded the LCC's actual requirements for contract gratuities. 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 of the Audit Report), there had been over-provisions of subvention for contract gratuities under the OLV arrangement totalling \$20.4 million over the past nine years. The FSTB's failure to adjust the subvention had led to the unjustified building up of the LCC's reserve (see para. 6.9 of the Audit Report).*

Audit Commission  
24 June 2003

**Audit comments on the letter from  
the Secretary for Financial Services and the Treasury  
to the PAC dated 19 June 2003**

**Paragraphs 2 and 3**

***FSTB's view***

The resources allocated to the LCC under the RAE in respect of new or enhanced services become part of the OLV and the LCC has the flexibility to deploy funds in the OLV among expenditure components in the most economical way as it sees fit, so long as the services are provided as specified in the LCC's resource bid. Furthermore, there is no requirement that the LCC must spend the resources allocated in accordance with the cost estimates in the resource bid.

***Audit comments***

*Audit recognises that the resources allocated to the LCC in RAEs become part of the OLV and the LCC has the flexibility to deploy funds among expenditure components. However, Audit considers that, although the LCC can deploy the funds in the way as it sees fit, it is an undeniable fact that the funds allocated in RAEs for the new posts created in 1996-97 to 1998-99 included an element intended to cover 100% of the year's contract gratuities for the new posts. Therefore, after a bid for new posts had been approved, the LCS should have adjusted the amount of new resources required so that the normal funding to the LCC included only the percentage (i.e. 15%) 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 (see para. 4.20(c) of the Audit Report).*

*Furthermore, as indicated in the third paragraph of his letter to the Secretary General of the LCS dated 23 August 1997 (on the 1997 RAE), the then Secretary for the Treasury stated that the LCC would not normally be allowed to repeat the request for funds for the same purpose in subsequent years. Audit considers that, unless the amount of new resources for the new posts had been adjusted so that the normal funding to the LCC included only the percentage (i.e. 15%) of the annual contract gratuities adopted by the three-year funding method, the double request for the funding for 85% of contract gratuities per year for the new posts is a duplication of the request for funds for the same purpose. This has in fact breached the Secretary's condition of approval for new resources for the new posts.*

Audit Commission  
24 June 2003

**Audit comments on the letter from  
the Secretary General of the Legislative Council Secretariat  
to the PAC dated 19 June 2003**

**Whether funding requests are in respect of services or in respect of posts**

*LCC's view*

Requests for additional funding in each RAE are in respect of new or improved services, and not for the creation of posts. New funds are not earmarked for any posts, and the LCC has the freedom to deploy new resources allocated through an RAE.

*Audit comments*

*Audit wishes to point out that every year when the Star Chamber considered whether additional resources were to be allocated in respect of services, the amount of allocation was, in fact, determined with reference to the new posts to be created for the services. This is indicated:*

- (a) in the letter dated 13 September 1996 and the fax dated 20 September 1996 on the 1996 RAE (for new posts to be created in 1997-98); and*
- (b) in the letter dated 8 August 1997 on the 1997 RAE (for new posts to be created in 1998-99)*

*from the then Secretary for the Treasury to the Secretary General of the LCS (see Appendixes IA, IB and II to the Director of Audit's letter to the PAC dated 19 June 2003).*

*Furthermore, although the LCC is free to deploy new resources allocated in RAEs, as indicated in the third paragraph in his letter to the Secretary General of the LCS dated 23 August 1997 (on the 1997 RAE), the then Secretary for the Treasury stated that the LCC would not normally be allowed to repeat the request for funds for the same purpose in subsequent years. Audit considers that, unless the amount of new resources for the new posts had been adjusted so that the normal funding to the LCC included only the percentage (i.e. 15%) of the annual contract gratuities adopted by the three-year funding method, the double request for the funding for 85% of contract gratuities per year for the new posts is a duplication of the request for funds for the same purpose. This has in fact breached the Secretary's condition of approval for new resources for the new posts.*

## **Information submitted to the FSTB to support funding applications**

### ***LCC's view***

To support funding requests for new or improved services, the LCC estimates the service level to be achieved and the plans for delivering such services. The plan can be additional staff, use of technologies and/or hiring of outside services. It is for budgetary purposes and can be changed in the implementation stage.

### ***Audit comments***

*Upon review of the information submitted by the LCS to support the funding bids in RAEs. Audit found that funding requests were made with reference to the new posts to be created for the services. This is indicated in the letter from the Secretary General of the LCS to the then Secretary for the Treasury dated 12 June 1997 on the 1997 RAE (for posts to be created in 1998-99 — see Annex).*

## **Whether cash allowances and contract gratuities are relevant information in funding applications**

### ***LCC's view***

Funding for existing services did not take into account the amount of cash allowance and contract gratuities payable by the LCC. Funding was based on the financial provision approved in the previous year. Regarding funding requests for new or improved services, if the plan is to employ additional staff, the estimated staff costs will be used for budgeting the resources required. Salary, cash allowance and contract gratuities involved are taken into account in estimating the staff costs. However, the LCC's funding requests are in respect of the overall cost for the new or improved services, and not for any specific components.

*Audit comments*

*Because funding for existing services did not take into account the amount of cash allowance and contract gratuities required by the LCC, government funds were provided to the LCC which was actually not required by the LCC. There had been over-provisions of subvention under the OLV arrangement totalling \$50.9 million over the past nine years (see para. 6.9 of the Audit Report).*

*The LCC said that the LCC's funding requests were in respect of the overall cost for the new or improved services, and not for any specific components. However, it is an undeniable fact that the funds allocated in RAEs for the new posts created in 1996-97 to 1998-99 included an element intended to cover 100% of the year's contract gratuities for the new posts. Therefore, after a bid for new posts had been approved, the LCS should have adjusted the amount of new resources required so that the normal funding to the LCC included only the percentage (i.e. 15%) 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 (see para. 4.20(c) of the Audit Report).*

*Furthermore, as indicated in the third paragraph of his letter to the Secretary General of the LCS dated 23 August 1997 (on the 1997 RAE), the then Secretary for the Treasury stated that the LCC would not normally be allowed to repeat the request for funds for the same purpose in subsequent years. Audit considers that, unless the amount of new resources for the new posts had been adjusted so that the normal funding to the LCC included only the percentage (i.e. 15%) of the annual contract gratuities adopted by the three-year funding method, the double request for the funding for 85% of contract gratuities per year for the new posts is a duplication of the request for funds for the same purpose. This has in fact breached the Secretary's condition of approval for new resources for the new posts.*

Audit Commission  
24 June 20093

*\*Note by Clerk, PAC: Annex to Appendix III not attached.*

### Audit's consolidated views

Audit is fully aware that the OLV funding arrangement for the LCC as set out in the EOL with the Administration provides flexibility in the deployment of resources while recognising the special status of the Legislature. Audit appreciates the merits of flexibility in the deployment of resources under such arrangement. However, Audit maintains the view that such flexibility should not be accorded at the expense of basic controls to any funding scheme. A basic control which should be incorporated into any funding scheme (particularly for organisations which are solely funded by public money), including the OLV arrangement, is a control over the actual funding requirements at the inception of the arrangement and at times when there are significant changes in circumstances.

At the time of inception and at times when there are significant changes in circumstances, thorough vetting by the Administration is necessary on the expenditure items to ensure that the funding is reasonable and adequate but is not more than that required by the LCC. Audit evidence indicates that, despite the significant decreases in CARs for staff of the LCS during the period 1994-95 to 2002-03 (as shown in Figure 1 in para. 3.5 of the Audit Report), the Administration failed to exercise the basic funding control by ascertaining the LCC's actual funding requirements and adjusting the subvention for the years following the changes. Audit's calculation has shown that each year, the over-provision of funds resulting from the LCC's reduced actual funding requirements has exceeded 10% of the subvention to the LCC for cash allowance since 1997-98 and has increased to 14% or more of such subvention since 1998-99.

Audit evidence also indicates that the provisions of funds for contract gratuities for staff of the LCS have exceeded the LCC's actual funding requirements both in respect of the new posts created during the period 1996-97 to 1998-99 for introducing new or enhanced services and in respect of a large number of posts of the LCS not filled by contract staff during the period April 1994 to April 1995 (see Appendix D of the Audit Report). 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 (see Appendix C of the Audit Report), 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. In Audit's view, the LCS should have reduced the contract gratuities included in the new resources for such new posts to *only* 15% of the year's contract gratuities to avoid over-provision. This is what the LCC had *correctly* done for the new posts created in 1995-96. Audit has also found that, at the time of the LCS's funding request made 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 Administration that a large number of posts were not filled by contract staff during the period April 1994 to April 1995.

Under the OLV arrangement:

- (a) funds are not segregated and earmarked for individual expenditure components such as cash allowance and contract gratuities (see paras. 3.13(a) and 3.16(b) of the Audit Report); and
- (b) government subvention to the LCC for its recurrent expenditure for each financial year is determined simply by adjusting the addition or reduction of resources to the LCC and then applying to the total amount a price adjustment factor prescribed by the FSTB, without ascertaining the actual funding requirements of individual expenditure components (see para. 1.11 of the Audit Report).

Ascertaining the actual funding requirements is an essential control which should be incorporated into any funding scheme, including the OLV arrangement. The deficiency of the OLV arrangement for the LCC is that the Administration has not exercised the basic funding control by ascertaining the LCC's actual funding requirements for cash allowance and contract gratuities. This has resulted in the over-provision of subvention to the LCC. **Audit considers that the Administration should exercise the basic control by ascertaining the LCC's actual funding requirement so as to ensure that the LCC would not be provided with funds which are not required.**

It is worthy of note that, since the LCC's establishment in April 1994, as the Secretary General of the LCS informed the PAC at the public hearing on 12 May 2003, there has never been any occasion that the LCC needs to use its reserve to meet any unforeseen requirements. The recurrent over-provision of subvention will lead to further increase in the LCC's reserve. **Therefore, Audit considers that urgent action should be taken by the Administration, in consultation with the LCC, to address the issues of over-provision of funds and the consequential rapid building up of the LCC's reserve by ten folds from \$10.1 million to \$101.6 million during the four financial years 1998-99 to 2001-02.** If the problems of over-provision of subvention for cash allowance and for contract gratuities for new posts are not addressed, they will lead to recurrent over-provision of subvention amounting to \$7.95 million a year, based on the data of the four financial years 1999-2000 to 2002-03. This annual over-provision is made up of:

- (a) \$5.2 million for cash allowance (see Table 1 in para. 3.9 of the Audit Report); and
- (b) \$2.75 million for contract gratuities for new posts (see Appendix E of the Audit Report).

**Audit considers that this amount of over-provision should be deducted from the annual subvention to the LCC.**

Audit Commission  
24 June 2003