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26 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**

I refer to the letter dated 25 June 2003 from the Secretary for Financial Services and the Treasury to the Public Accounts Committee (PAC) on the captioned subject. My comments on the views of the Financial Services and the Treasury Bureau (FSTB) are set out in the Appendix.

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 25 June 2003**

**Paragraph (a)(i)**

*FSTB's view*

Under the agreed funding method, The Legislative Council Commission (the LCC) is not subject to the Government's financial control at the level of expenditure components. Therefore, the FSTB does not seek and use information on the LCC's finances for the purpose of preventing "over-provision" to the LCC for individual expenditure components.

*Audit comments*

*As already explained in the fourth paragraph of Appendix IV to the letter from the Director of Audit to the PAC dated 24 June 2003, ascertaining the actual funding requirements is an essential control which should be incorporated into any funding scheme, including the one-line vote (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 funding arrangement lacks effective control. This has resulted in the over-provision of subvention to the LCC totalling \$50.9 million during the period 1994-95 to 2002-03 (see para. 6.5 of the Audit Report).*

**Paragraph (a)(ii)**

*FSTB's view*

As for the scenario of the funding arrangement for the LCC getting out of control, the FSTB envisages that with the information the FSTB maintains on the LCC's finances, the FSTB would not allow such a situation to happen, and would definitely take pre-emptive actions where necessary after discussion with the LCC. The FSTB also envisages that for its part, the LCC would exercise its statutory autonomy responsibly so that situation would not get out of control. Conversely, the FSTB does not think that it is necessary for the Government to maintain component-by-component control over the LCC to prevent such a scenario.

*Audit comments*

*There is adequate evidence to show that the FSTB's failure to adjust the subvention to the LCC, despite being aware of the decrease in the LCC's 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. Furthermore, as pointed out previously in the Appendix to the letter from the Director of Audit to the PAC dated 25 June 2003 (see the paragraph under the heading "General Audit comments" in the Appendix), according to the unaudited accounts of the LCC for the year ended 31 March 2003, the reserve of the LCC increased by a further 17.3% in 2002-03, from \$101.6 million as at 31 March 2002 to \$119.2 million as at 31 March 2003. According to the Exchange of Letters (EOL), the reserve may be spent at the discretion of the LCC so long as no such expenditure shall create a commitment on government funds without the approval of the Secretary for Financial Services and the Treasury. Under these circumstances, the OLV arrangement is ineffective and has got out of control (see paras. 6.7 and 6.9 of the Audit Report). Deliberate over-provision of funds to the LCC year after year is contrary to the principle of prudent financial management, particularly at the present time of severe budget deficits.*

**Paragraph (d)**

*FSTB's view*

It is correct that the FSTB does not provide additional subvention to the LCC when the cash allowance rates (CARs) are revised upwards, nor reduces subvention when the CARs decrease. Clause 3.2 of the EOL is a general provision enabling the Secretary General of the Legislative Council Secretariat (LCS) to request extra funding from the Government, if the Secretary General feels that such extra funding is required, during the course of a financial year, to meet extra costs in connection with a limited list of items, including salaries and allowance.

*Audit comments*

*According to Clause 3.2 of the EOL, the subvention to the LCC will be increased where additional funds are required to meet the cost of cash allowance in accordance with the CARs (see para. 1.14 of the Audit Report). However, if the subvention exceeds the requirement in respect of cash allowance in accordance with the CARs, it is only reasonable and logical to expect that the subvention would be reduced. Therefore, the FSTB should have adjusted the subvention to the LCC for cash allowance to take into account the reduction in subvention requirements as a result of the significant decrease in CARs and the fact that some staff of the LCS chose not to receive cash allowance.*

***FSTB's view***

Over the years, the LCC has not found that extra funding is required as a result of increases in CARs, and has not requested extra funding. It has also been the agreed practice that the LCC will not request extra funds for cash allowance on account of increase in CARs, considering, among other things, that an increase in CARs will not immediately increase the LCC's cost on cash allowance.

***Audit comments***

*According to the EOL, the subvention to the LCC will be increased if additional funds are required to meet the cost of cash allowance in accordance with the CARs (see para. 1.14 of the Audit Report).*

**Paragraph (e)**

***FSTB's view***

The FSTB has not verified the figures. But it is a fact that \$4.8 million is more significant than \$0.746 million.

***Audit comments***

*The amount of over-provision in 2002-03 due to the decrease in CARs amounted to \$4.8 million (see Table 2 in paragraph 3.10 of the Audit Report). This table had been included in the draft audit report (as Table 4 in para. 2.9), which was forwarded to the FSTB on 23 January 2003 for comments and verification.*

**Paragraph (f)**

***FSTB's view***

The FSTB considers that adjusting the subvention to the LCC for contract gratuities to reflect the actual subvention requirements would be inconsistent with the OLV arrangement. If the FSTB compares the actual expenditure of the LCC with the subvention of a special expenditure component and claw back under-spending, it could be argued that the FSTB should also provide additional funds in case the actual expenditure on an expenditure component is larger than the level included for the component in the block grant.

*Audit comments*

*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 adequate evidence of a major and continual change in the actual subvention requirements. There is a need to establish an adjustment mechanism (see para. 3.17(b) of the Audit Report).*

*Furthermore, there is a mechanism whereby the FSTB would provide additional funds in case the funding requirement on an expenditure component (such as cash allowance and contract gratuities) is larger than the subvention for the expenditure component included in the OLV. According to the EOL, subvention to the LCC will be increased where additional funds are required to meet the cost of (see para. 1.14 of the Audit Report):*

- (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.*

*However, there is no mechanism for the FSTB to reduce the subvention to the LCC if the funding requirement on an expenditure component is smaller than the subvention for the expenditure component included in the OLV. This is clearly an unsatisfactory funding arrangement.*