Chapter 2

Subvention for staff emoluments of The Legislative Council Commission

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Audit conducted a review on the Government's funding for staff emoluments of The Legislative Council Commission (the LCC).

2. At the public hearing, **Mr Ricky FUNG Choi-cheung, Secretary General of the Legislative Council Secretariat (LCS)**, made an opening statement. Referring to paragraph 2.4(b) of the Audit Report, which stated that it was the responsibility of a Controlling Officer to inform immediately the Secretary for Financial Services and the Treasury where he had reason to believe that funds surplus to requirements existed under a subhead so that the excess might be reserved, the **Secretary General of the LCS** said that:

- the LCC was a statutory corporation established under The Legislative Council Commission Ordinance (the LCCO). Apart from the general provisions of the LCCO, the LCC had entered into the Exchange of Letters (EoL) with the Administration. The EoL set out the general principles and guidelines governing the administrative arrangements for the LCC and its working relationship with the Administration. Paragraph 3.4 of the EoL clearly stated that "Any surplus of income over expenditure at the end of the year may be kept in the Reserves of the Commission." This provision was thought necessary as it was contemplated that under the funding arrangement agreed between the LCC and the Administration as reflected in the EoL which was to give effect to the LCCO, there could be surpluses from provisions made to the LCC from time to time. It would put the Secretary General in an invidious position if he were required to inform the Secretary for Financial Services and the Treasury of surpluses in order that the surpluses might be reserved. Under the LCCO and the EoL, it was for the LCC to decide whether any surplus of income over expenditure at the end of the financial year should be kept in its reserves; and

- in practice, the Financial Services and the Treasury Bureau (FSTB) was aware of the financial position of the LCC. An analysis of the LCC's recurrent account was forwarded to the FSTB in the process of the preparation of the Annual Estimates. As shown in the analysis for the 2003-04 Estimates, in ***Appendix 18***, there was an item on "Transfer to/(from) Operating Reserve". In addition, every year the Secretary for Financial Services and the Treasury was given a copy of the LCC's annual report containing the Director of Audit's report on the LCC's accounts.

3. Regarding Audit's observations and recommendations generally, the **Secretary General of the LCS** said that:

- the one-line vote (OLV) funding arrangement for the LCC as set out in the EoL reflected the agreement by the Administration to recommendations made by the 1993 President's Working Group. That arrangement was to ensure flexibility in the deployment of resources and to recognise the prestige and special status of the Legislature. It was not for the purpose of treating the LCC on par with other non-government bodies which received funding from the Government under the Government's subvention policy and which were classified as subvented bodies. The LCC served a unique function of providing administrative support and services to the Legislature through the LCS. The enactment of the LCCO was to ensure the LCC's financial and managerial autonomy so that the Legislature could be given the necessary support to carry out its constitutional function independently in an effective and efficient manner. Therefore, the LCC should not be taken as a subvented organisation to which the Government's subvention policy is applicable; and

- since its inception in 1994, the LCC had been acting faithfully within the authority conferred on it by the LCCO in its implementation of the funding arrangement set out in the EoL. In this regard, the Commission had enjoyed the full cooperation of the Administration. There was no question of calculation errors in cash allowance and contract gratuities, or over-requisition of funds.

4. After the public hearing, the **Secretary General of the LCS** provided a letter, in ***Appendix 19***, on the LCC's response to the major observations and recommendations in the Audit Report.

Contract gratuity provided to non-professional and supporting staff

5. The Committee noted from paragraph 5.8 of the Audit Report that according to the guidelines stipulated in Finance Bureau Circular Memorandum (FBCM) No. 10/99, in view of the financial implications, Controlling Officers should seek the FSTB's prior agreement if they offered to non-professional and supporting staff contract gratuity of more than 10% of the basic salary. However, as the Controlling Officer, the Secretary General of the LCS had not sought the FSTB's prior agreement on offering contract gratuity to newly recruited non-professional and supporting staff at a level of 15% of their basic salary. According to paragraph 5.12, the LCC had informed Audit 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.

6. The Committee further noted Audit's recommendation in paragraph 5.14 that the Secretary for Financial Services and the Treasury should seek the Department of Justice's advice as to whether the LCCO had conferred discretionary powers on the LCC to offer contract gratuity to staff of the LCS at a level higher than that prescribed by the FSTB, without seeking the FSTB's prior agreement.

7. In response to the Committee's request, the **Secretary for Financial Services and the Treasury** informed the Committee, in his letter of 9 May 2003 in ***Appendix 20***, of the legal advice that the FSTB had obtained. He said that, according to the legal advice:

<u>The powers of the LCC</u>

- section 10 of the LCCO provided for the powers of the LCC. The LCC might, among other powers, "employ staff in the Secretariat, ... and determine their numbers, grading, duties, remuneration and other terms and conditions of service" (section 10(1)(b)). The LCC might also "formulate and execute such managerial and financial policies as the Commission considers expedient to the performance of its functions" (section 10(1)(e)) and "receive and expend funds" (section 10(1)(h));

- the LCC was a statutory body independent of the Government (section 19) and in relation to the formulation and execution of managerial and financial policies, it should not be "subject to any direction or control of any person" (section 17(1)), with the exception of the Legislative Council (LegCo), which might by resolution give directions of a general or specific character to the LCC in relation to the performance of its functions or the exercise of its powers (section 17(2));

- though the LCC enjoyed considerable statutory powers under the LCCO, those discretionary powers were not absolute or unlimited. So far as was relevant to the present problem, the LCC "shall ensure that the grading, remuneration and other terms and conditions of service of staff of the Secretariat are kept, ... **broadly in line** with those applicable to persons employed in the Civil Service of the Government" (section 10(2)). It was worth noting, however, that the LCCO did **not** require the LCC to ensure that the remuneration and other terms and conditions of the Secretariat staff were the same or no better than those employed in the Civil Service. They must only be "broadly in line" with those in the Civil Service. What was "broadly in line" was not defined in the LCCO. It was essentially a question of fact. The remuneration might therefore be fixed at a level exceeding that in the Civil Service and this would not infringe section 10(2) so long as the degree of excess was reasonable. Further, the LCC might also deviate from this general requirement imposed under section 10(2) as this was "subject to the Commission's discretion to make exceptions in such cases **as it sees fit**". In short, the LCC enjoyed considerable power in determining remuneration and other terms and conditions of its Secretariat staff;

- however, the LCC was expected to exercise the statutory discretionary powers reasonably. The fixing of an arbitrary sum for wages without regard to existing labour conditions could amount to an improper exercise of the statutory powers. However, in the present case, it appeared that the LCC had carefully considered the level of payment before arriving at the decision. It could not be said that its decision was arbitrary or otherwise irrational, though the Audit Commission had considered that on the basis of the employment market situations the LCC did not have "strong justifications" for its decision (paragraph 5.13 of the Audit Report);

<u>The legal effect of FBCM No. 10/99</u>

- FBCM No. 19/99 did not prevail over the statutory provisions in the LCCO or the statutory powers enjoyed by the LCC under the LCCO. The memorandum was issued on 27 May 1999 by the then Secretary for the Treasury. It was addressed to Bureau Secretaries and Controlling Officers. (<u>NB</u> The Secretary General of the LCS was designated as a Controlling Officer.) It appeared to be a policy statement which "advises on the level of contract gratuity that subvented organisations may provide to their staff for the purpose of Government subvention" (paragraph 1). The memorandum required the Controlling Officers to "bring this to the attention of subvented organisations under their purview" (paragraph 1). It also required "the Controlling Officers to seek Finance Bureau's prior agreement in the light of financial implications involved where they support individual cases of appointment in subvented organisations providing gratuity at a level higher than the prescribed levels" (paragraph 7);

- being **administrative** in nature, FBCM No. 10/99 did not and could not override the **statutory** provisions or powers enjoyed by the LCC under the LCCO. More specifically, in determining remunerations, the LCC was only obliged to ensure that they were kept "**broadly in line** with those applicable to persons employed in the Civil Service of the Government" (section 10(2)). Further, section 16(2) of the LCCO expressly provided that the Secretary General of the LCS was not required to obey such a regulation, direction or instruction which was concerned solely with the expenditure of the LCC unless the Financial Secretary had consulted the LCC before it was issued. And the LCC had not been consulted in respect of the memorandum; and

- the statutory powers of the LCC under the LCCO had not been reduced or otherwise prejudiced by the FBCM. Nevertheless, the FBCM might have provided guidelines for the LCC in exercising its statutory powers. And the LCC might have considered it before making a decision on the provision of contract gratuity for its non-professional and supporting staff at a higher rate.

8. Referring to the FSTB's legal advice, the Committee enquired whether there were other publicly-funded organisations which enjoyed the same degree of financial autonomy as the LCC. **Mr Stanley YING, Deputy Secretary for Financial Services and the Treasury (Treasury)**, said at the hearing and the **Secretary for Financial Services and the Treasury** stated in his letter of 29 May 2003, in ***Appendix 21***, that:

- the statutory financial and administrative autonomy of the LCC was laid down in the LCCO. Relevant provisions included section 10(1)(e), which stipulated that the LCC might "formulate and execute such managerial and financial policies as the Commission considers expedient to the performance of its functions". Section 16(2) stated that "Section 13 of the Public Finance Ordinance (Cap. 2) shall not apply to the Secretary General in relation to regulations, directions or instructions made or given by the Financial Secretary under section 11 of that Ordinance which are concerned solely with the expenditure of the Commission unless the Financial Secretary has consulted the Commission before such regulations, directions or instructions are made or given". Sections 17(1) and 17(2) provided that the LCC "shall not, in relation to the formulation and execution of managerial and financial policies of it or the Secretariat, be subject to any direction or control of any person", except for those directions given by the LegCo by resolution in relation to the performance of the Commission's functions or the exercise of its powers; and

- the legislation of some subvented organisations provided for certain extent of financial autonomy, but the FSTB was not aware of any subvented organisations whose legislation provided for the same extent of financial autonomy as that stipulated in the LCCO.

9. Noting the FSTB's legal advice that FBCM No. 10/99 did not prevail over the statutory provisions in the LCCO or the statutory powers enjoyed by the LCC, the Committee asked whether the guidelines provided in the FBCMs were applicable to the LCC.

10. **Mr Alan LAI Nin, Permanent Secretary for Financial Services and the Treasury (Treasury)**, and the **Deputy Secretary for Financial Services and the Treasury (Treasury)** advised that:

- the LCC was given statutory powers under the LCCO while many subvented organisations were not established under their own legislation. Hence, the LCC should not be treated in the same way as other subvented organisations. Not all the financial guidelines issued to subvented organisations by the Administration were applicable to the LCC; and

- on the other hand, for the sake of financial management, the Administration issued financial guidelines to all organisations which received government funding, including the LCC, and expected them to comply with the guidelines. If they were unable to follow the guidelines due to special reasons, they could discuss with the FSTB. Similarly, if the LCC considered that it should exercise its statutory powers and should not comply with the guidelines, it could set out the reasons and discuss with the FSTB. As a matter of fact, the LCC had followed most of the guidelines issued by the Administration in the past years.

11. In response to the Committee's enquiry, the **Permanent Secretary for Financial Services and the Treasury (Treasury)** supplemented that the LCC was expected to comply with the Standing Accounting Instructions (SAIs) and Financial and Accounting Regulations (FARs) referred to in paragraphs 2.3 and 2.4 of the Audit Report. The LCC could consult the FSTB where it had difficulty in following the instructions and regulations. Normally, the LCC could deviate from the requirements if it could provide justifications.

12. The Committee asked about the action that the LCC would take where it encountered difficulties in following the FSTB's guidelines or where it considered that the guidelines should not be complied with.

13. The **Secretary General of the LCS** said that generally, the LCC would follow the financial instructions and regulations. However, he was not required to comply with FAR 320 which required that where Controlling Officers had reasons to believe that funds surplus to requirements existed, they should inform the Secretary for Financial Services and the Treasury of such surplus so that the excess might be reserved. This was because under the LCCO and the EoL, the LCC might keep the surplus funds in its reserves. As a matter of fact, the FSTB was fully aware of the surplus of the LCC as it was reported in the LCC's financial reports and statements submitted to the FSTB every year.

14. The Committee enquired whether the LCS, in cases where it considered that the FSTB's guidelines should not be complied with, would bring the non-compliance to the LCC's attention and provide the justifications for the LCC's final decision. The **Secretary General of the LCS** replied that he would certainly consult the LCC on matters of policy, including non-compliance with the FSTB's guidelines.

15. Regarding the LCC's decision made on 13 April 2000 to offer contract gratuity at 15% of the basic salary, instead of no more than 10% as stipulated in the FSTB's guidelines, to newly recruited non-professional and supporting staff of the LCS, the Committee asked whether:

- in making the decision, the LCC had taken into account the rapid changes in employment market situations;
- the LCC had explained its decision publicly at that time; and
- the LCC would consider reviewing its decision as suggested by Audit.

16. The **Secretary General of the LCS** explained that:

- the LCC's decision of a uniform rate of contract gratuities (i.e. 15% of the basic salary) for all LCS staff recruited since June 1999 was based primarily on equity principles, rather than on employment and market situations. For instance, as mentioned in paragraph 5.5(a) of the Audit Report, 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; and
- the LCC was reviewing the level of contract gratuity for non-professional and supporting staff.

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17. In his letter of 22 May 2003, in ***Appendix 22***, the **Secretary General of the LCS** further informed the Committee that:

- meetings of the LCC were not open to the public. The papers and records of such meetings were not distributed to the public, as most issues deliberated by the LCC were in respect of internal management matters concerning the LCS. However, if there were press enquiries on matters discussed by the LCC, the Chairman of the LCC invariably responded to the enquiries, unless they were on issues which were confidential, such as those relating to the Director of Audit's draft report before its tabling in the LegCo;

- one of the features of the LCC's managerial and financial autonomy was reflected in the LCCO by the LCC's power to determine the terms and conditions of its staff, subject to the only condition that such terms and conditions had to be kept broadly in line with those applicable to persons employed in the Civil Service. The so-called "no better than" principle which the Government applied to subvented organisations did not apply to the LCC. 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, the reasons given by the Secretary General in LegCo Paper No. LCC 34/99-00 (reproduced in paragraph 5.5 of the Audit Report) as well as the fact that a number of statutory organisations operated under the OLV system paid contract gratuity to their non-professional and supporting staff at 15% of their basic salary, the LCC made a policy decision on 13 April 2000 that such staff in the LCS should be paid contract gratuity at 15% of their basic salary; and

- in view of the lapse of time since 2000, the LCC had recently reviewed its decision. The LCC had decided at its meeting on 20 May 2003 to lower the rate of contract gratuity for newly appointed non-professional and supporting staff to 10% of their basic salary, having regard to the following factors:

  (a) the public was concerned about the stringent financial climate in Hong Kong;

  (b) no apparent adverse impact on the quality of service or recruitment difficulty might result from a lowering of the rate of contract gratuity for such staff in view of the current labour market; and

  (c) some of the statutory organisations mentioned above had lowered the rate of contract gratuity for such staff.

Reserve of the LCC

18. The Committee referred to the statement of the Secretary General of the LCS that the FSTB was aware of the financial position of the LCC as reported in the LCC's financial reports and statements submitted to the FSTB every year. The Committee enquired whether, in the Administration's opinion, the submission of financial reports and statements to the FSTB was sufficient to draw its attention to the existence of surplus in the LCC's accounts.

19. The Committee further referred to Figure 2 in paragraph 6.3 of the Audit Report, which depicted the balance of the LCC's Operating Reserve Account from 1994-95 to 2001-02. It showed that there had been significant increases in the LCC's reserve since the end of 1998-99. The Committee asked whether the Administration, based on the information provided by the LCC, was able to identify the reasons for the rapid build-up of the LCC's reserve.

20. The **Permanent Secretary for Financial Services and the Treasury (Treasury)** responded that the FSTB was aware of the LCC's surplus and reserve when it discussed with the LCS the LCC's draft estimates of expenditure for the following financial year. However, the FSTB would not ask how the LCC achieved the surplus as the LCC had autonomy in deploying the funds allocated to it. The Administration did not know the reasons for the rapid increases in the level of the LCC's reserve since the end of 1998-99.

21. On the question of whether the Administration had knowledge of the detailed breakdown of the LCC's accounts, **Mr Dominic CHAN Yin-tat, Director of Audit**, commented that:

- according to Audit's examination, the LCS had forwarded the detailed breakdown of its accounts to the FSTB. There was no question of the LCS withholding information. The crux of the matter was whether the FSTB had analysed the information submitted to it; and

- Audit had not suggested that the Administration should micro-manage the funding to the LCC. Instead, the FSTB should exercise the basic funding control by ascertaining the actual requirements of the LCC and adjusting the allocation to the LCC where there were significant changes in circumstances. Otherwise, the OLV funding arrangement could get out of control.

22. The Committee enquired about the transparency of the LCC's income and expenditure position. In response, the **Permanent Secretary for Financial Services and the Treasury (Treasury)** and the **Secretary General of the LCS** said that under section 13 of the LCCO, the LCC was required to arrange for its statement of accounts to be audited and for the audited statement of accounts and the auditor's report to be tabled in the LegCo. The Director of Audit was in fact the LCC's auditor. The expenses and surpluses of the LCC were set out clearly in its financial statements which had a high degree of transparency.

23. The Committee noted from paragraph 6.4 of the Audit Report that the maximum level of reserve of the LCC had not been mentioned in the EoL. According to paragraph 6.8, the LCC considered that it would be inconsistent with the rationale of the OLV funding arrangement adopted for the LCC if a maximum level was to be set for its reserve. The existing provisions in the EoL should remain unchanged. The Committee further understood from paragraph 6.10 that for many organisations receiving similar block grant funding, the Government had set different levels of maximum reserve, up to which they were allowed to keep their unspent funds. The Committee therefore asked about:

- the types of publicly-funded organisations that were allowed to keep a reserve and those that were not; and

- the maximum level of reserve in respect of those organisations that were allowed to keep a reserve.

24. In his letter of 29 May 2003, the **Secretary for Financial Services and the Treasury** stated that the arrangement on reserve varied among subvented organisations. He also provided some examples of the range of such arrangements which showed that some organisations, such as the Employees Retraining Board, the Hong Kong Tourism Board and the Hospital Authority, had a ceiling set for their reserve. On the other hand, the Office of The Ombudsman, the Consumer Council, the Hong Kong Trade Development Council, the Equal Opportunities Commission, and the Office of the Privacy Commissioner for Personal Data did not have a ceiling set for their reserve.

25. The Committee asked whether the Secretary General of the LCS had informed the LCC of the high level of reserve and whether the LCC had discussed the appropriateness of the level and the possible uses of its reserve.

26. The **Secretary General of the LCS** replied that:

- both the LCC and the FSTB were fully aware of the LCC's reserve level. The Government had been providing funds for the LCC entirely in accordance with the agreed funding mechanism. The LCC's reserve had been built up over the past nine years through prudent management of funds;

- as provided in the EoL, the reserve "may be spent at the discretion of the Commission subject to the proviso that no such expenditure shall create a commitment on government funds without the prior approval of the Secretary for the Treasury". Under such a constraint, the LCC had not spent its reserve in the past nine years. However, given the current stringent financial climate, it was anticipated that the Government might not allocate supplementary provision to fund the LCC's additional services. In the circumstances, the LCC would use its operating reserve to meet unforeseen expenses, such as those in connection with select committees; and

- the LCC had not considered setting a ceiling for its reserve because to do so would be inconsistent with the rationale of the OLV funding arrangement adopted for the LCC.

27. Noting that many organisations which operated under the OLV funding arrangement had a maximum level set for their reserve, the Committee asked whether the Administration agreed to the LCC's view that setting a reserve ceiling was against the spirit of the OLV system.

28. **Hon Frederick MA Si-hang, Secretary for Financial Services and the Treasury**, and the **Permanent Secretary for Financial Services and the Treasury (Treasury)** said that:

- it was not specified in the OLV system whether or not a maximum level should be set for an organisation's reserve or what level of reserve was appropriate; and

- subject to the views of the LCC, the Administration did not have objection to Audit's recommendation that a ceiling be set for the LCC's reserve. However, to implement the proposal, the EoL would have to be amended. Whilst either the Administration or the LCC might propose changes to the EoL, amendments to the EoL could only be made with the agreement of both parties.

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29. The Committee further asked:

- whether, where there was significant increase in salaries, the LCC could seek additional provision from the Administration or had to fund the increased cost from its reserve;

- why the LCC did not need to fund the operation of select committees from its reserve in the past but had to do so in future; and

- about the LCC's expenditures on select committees in each of the past three financial years.

30. The **Secretary General of the LCS** stated that the Administration would provide additional funds to meet the cost of increased salaries due to Civil Service pay adjustment. Regarding select committees, in the past, the Administration had provided supplementary provisions to meet the costs of such committees. But this might not be the case in future.

31. In his letter of 14 June 2003, in ***Appendix 23***, the **Secretary General of the LCS** provided information on the LCC's expenditures on select committees, as follows:

Year	$ million
2000-01	0.5
2001-02	6.8
2002-03	8.0
Total	15.3

32. In response to the Committee's enquiry on the Government's policy in this regard, the **Permanent Secretary for Financial Services and the Treasury (Treasury)** explained that the Administration had, in the past, allocated supplementary funds to meet additional expenses of the LCC. In assessing the funding requests, the Administration had taken into account the circumstances of each application and the Government's overall financial position. The Administration could not guarantee that additional resources would definitely be allocated to the LCC for select committees. Instead, it was agreed that the LCC should keep a reserve to fund unforeseen activities which did not incur recurrent expenditures.

33. Regarding the LCC's views on its reserve, the **Secretary General of the LCS**, in his letter of 23 May 2003 in ***Appendix 24***, supplemented that:

- the LCC had managerial and financial autonomy conferred on it by the LCCO. When exercising its managerial and financial autonomy, the LCC had always been conscious of the need for economy and had been prudent in the management of its financial resources since its inception nine years ago;

- while mindful of the LCCO's requirement that the terms and conditions of service of staff of the LCS should be broadly in line with those of civil servants, the LCC did vary the terms and conditions of service of LCS staff, which resulted in their being less favourable than those of civil servants in certain cases. Examples included the payment of acting allowance only for acting appointments lasting for more than three months (as opposed to the one-month requirement in the Civil Service), and the non-payment of contract gratuity for temporary staff employed for less than three years (as opposed to the general practice in the Civil Service for paying contract gratuity to temporary staff employed for longer than one year); and

- the LCC would use its reserve to fund activities for which no provision had been made. While this was the principle the LCC had been adhering to in its utilisation of its reserve, the LCC had in fact resolved on 24 October 2002 that it would fund the operation of future select committees from its reserve in order to reduce the Government's expenditure. The LCC had no intention of keeping the reserve purely for the sake of keeping it.

Provision of funding for cash allowance and contract gratuity

34. As stated in paragraph 3.14(a) of the Audit Report, Audit considered that one basic control in any funding system, including the OLV funding arrangement, was a control over the actual funding requirements at the inception of the arrangement and at times when there were significant changes in circumstances. Paragraph 4.17 revealed that the LCS had included in its funding request in May 1995 the contract gratuities for posts that were not filled by contract staff during the period April 1994 to April 1995. The Committee asked:

- whether there had been any significant changes in circumstances which the LCC should have brought to the attention of the FSTB during the past nine years since the inception of the LCC in 1994;

- why the LCC had not informed the Administration that it was not necessary to allocate funding for the contract gratuities for those posts that were not filled by contract staff; and

- whether, at that time, the Administration knew the pace of the LCC's replacement of seconded civil servants by contract staff.

35. The **Secretary General of the LCS** responded that:

- he did not consider that there had been significant changes in circumstances since 1994; and

- the year 1994-95 was the first year of the LCC's establishment. At that time, the LCC could not accurately estimate the progress of replacing civil servants that could eventually be made in the course of the year. The contract gratuities applied for 1996-97 had been calculated according to the funding method mutually agreed between the then Finance Branch and the LCC.

36. The **Permanent Secretary for Financial Services and the Treasury (Treasury)** said that:

- the OLV funding arrangement agreed between the Administration and the LCC was special. Under such an arrangement, the Administration allocated funding to the LCC based on broad principles instead of specific items of expenditure. The Administration knew how the LCC would spend its resources but did not micro-manage the provisions granted to it. To do so would be inconsistent with the spirit of the OLV funding arrangement; and

- the Administration did not perceive that there had been significant changes in circumstances since the establishment of the LCC. In 1994-95, it fully understood that the LCC would try to replace seconded civil servants by contract staff as soon as possible within one year. Funding for contract gratuity had been provided to the LCC on the basis of this broad principle which was agreed to between the Administration and the LCC.

37. The Committee noted Audit's view that the FSTB should have reduced the funding to the LCC for cash allowance, taking into account the significant changes in circumstances, i.e. the reduction in the LCC's funding requirements as a result of the significant decrease in cash allowance rates (CARs) during the nine-year period from 1994-95 to 2002-03 and some staff of the LCS having chosen not to receive the cash allowance.

38. The Committee asked whether:

- under the OLV funding arrangement, the Administration had put in place an adjustment mechanism whereby it would review the actual funding requirements of the LCC after the LCC had been established for a long time; and

- the Administration agreed that the decrease in CARs and the fact that some LCS staff had opted not to receive the cash allowance were significant changes in circumstances that had warranted such a review by the Administration.

39. The **Secretary for Financial Services and the Treasury** said at the public hearing and in his letters of 29 May 2003 and 17 June 2003, in ***Appendices 21 and 25*** respectively, that:

- as agreed between the LCC and the Administration and as reported to the Finance Committee, funding to the LCC was in the form of an OLV, and not broken down into components of expenditure. In using the OLV method, the LCC and the Administration were conscious that the LCC had the autonomy and flexibility in deploying funds in the OLV among types of expenditure, and was not subject to the Administration's control at the level of components of expenditure. The Administration therefore did not prescribe a provision for a component of expenditure (such as cash allowance), and consequently there was no question of the Administration "over-providing" or "under-providing" the LCC on a component of expenditure such as cash allowance;

- the Administration did not provide additional funding to the LCC when the CARs were revised upwards, nor reduced the funding when the rates were decreased; and

- since the funding arrangement agreed with the LCC anticipated that any increase or decrease in the LCC's funding requirement for cash allowance would not affect the level of the OLV, such increase or decrease in expenditure on cash allowance was not significant changes in circumstances.

40. The Committee further enquired whether the FSTB had detected that the LCS's funding request had not reflected the decrease in CARs and the reduction in funding requirements as some staff had chosen not to receive the cash allowance.

41. The **Secretary for Financial Services and the Treasury**, in his letter of 17 June 2003, advised that the FSTB had not detected the above circumstances relating to cash allowance. This was mainly because the established OLV funding arrangement for the LCC did not envisage the adjustment of government funding to reflect the LCC's actual expenditure on cash allowance. He further said that the following considerations might also be relevant:

- the cash allowance of an LCS staff member was calculated by multiplying his mid-point salary by the CAR for his category, and the amount of cash allowance was fixed throughout the contract period, which was usually three years. 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 had their contracts renewed or had been replaced by new recruits, the resultant savings would be $0.746 million, which amounted to only 0.3% of the 2002-03 approved estimates for the LCS's staff emoluments and general expenses (i.e. $246.55 million);

- if the Administration were to reduce such savings from the LCC's funding, it would have to keep track of the LCC's contract renewals or recruitment of new staff as and when they happened. That would not be an OLV method, and would involve the Administration's detailed monitoring of the LCC's contracts with staff;

- according to the LCC, some of the LCS staff had chosen not to receive the cash allowance out of compliance with the "prevention of double benefits" rule. But such personal situation of each staff member was not static and as his situation changed, e.g. in his marital status or the employment of his spouse, he might become eligible for the allowance. Conversely, a staff member who had been claiming the allowance might become ineligible for similar reasons. If the Administration were to adjust the funding to the LCC to reflect such changes in the personal situation of each staff member, it would again have to engage in detailed monitoring of the LCC over such matters; and

- to be consistent, the Administration would need to extend such detailed monitoring over other types of staffing and expenditure matters of the LCC, so that funding to the LCC could be adjusted in accordance with actual expenditure on these other expenditure components. This, however, would defeat the purpose of having an OLV funding arrangement for the LCC.

42. According to Table 1 in paragraph 3.9 of the Audit Report, there had been over-provision of $30.5 million to the LCC for cash allowance during 1994-95 to 2002-03. The Committee asked why the FSTB had not adjusted the funding to the LCC despite the consistently significant "over-provision".

43. The Committee also noted that, according to paragraph 3.2 of the EoL, additional funds would be provided to the LCC to meet the cost of salaries and allowances in accordance with approved rates and scales. The Committee asked why, despite such a provision, the FSTB would not provide additional funding to the LCC when the CARs were revised upwards.

44. In his letter of 25 June 2003 in ***Appendix 26***, the **Secretary for Financial Services and the Treasury** explained that:

- the figures listed in Table 1 of the Audit Report would be "over-provisions" if the LCC had been funded not under the OLV but under the line-by-line control or deficiency funding methods. Under those methods, there was, in general, an arrangement for the Government to claw back over-provisions and top up under-provisions. Given such possible fluctuations in demand on government funding, the Government often imposed control over expenditure components;

- paragraph 3.2 of the EoL was a general provision enabling the Secretary General of the LCS to request extra funding from the Government if he felt that such extra funding was required, during the course of a financial year, to meet extra costs in connection with a limited list of items, including "salaries and allowances"; and

- in the specific case of cash allowance, over the years, the Secretary General of the LCS had not found that such extra funding was required as a result of increases in CARs, and had not requested extra funding. It had also been the agreed practice between the LCC and the Government that LCC would not request extra funds for cash allowance on account of increases in CARs, considering among other things that an increase in CARs would not immediately increase the LCC's cost on cash allowance given that the cash allowance was fixed by amount during the duration of a contract.

45. Turning to the LCS, the Committee enquired:

- whether it had to perform extra work to keep track of the actual funding requirements for cash allowance; and

- why it had not specifically drawn the attention of the Secretary for Financial Services and the Treasury to the consistently significant "over-provision" of funding for cash allowance.

46. In his letter of 24 June 2003, in ***Appendix 27***, the **Secretary General of the LCS** informed the Committee that:

- the LCC kept record of each payment of cash allowance, but did not track the reason for the payment or non-payment for each post;

- non-payment at a certain point in time did not necessarily mean that funding was not required at a future point in time. For example, an LCS staff member might, in compliance with the "double benefit rule", choose not to receive the cash allowance (i.e. opt-out) this year because his/her spouse enjoyed fringe benefits such as housing and/or education allowances from his/her spouse's employment. However, he/she might "opt-in" next year on his/her spouse's cessation, for whatever reason, to enjoy such benefits;

- in order to keep track of the actual funding requirements for cash allowance, the LCS had to identify the reasons for all the payments and non-payments of cash allowance, e.g. staff choosing not to receive cash allowance, temporary vacancies, frozen posts, staff on no-pay leave not entitled to cash allowance or posts filled by temporary staff not entitled to cash allowance. To do so would involve extra work;

- to make such extra work meaningful, apart from tracking the reason for the payment or otherwise of cash allowance for each post, it would also be necessary to determine whether appropriate adjustments should be made to the funding requirements. However, such comparison of the cash allowance provision for each post with the cash allowance expenditure for that post was unwarranted and uncalled for under the OLV funding arrangement. If such tracking was required, other "components" of expenditure would also have to be tracked in order to ascertain whether each and every component was over-funded or otherwise;

- fundamentally, the OLV funding arrangement for the LCC did not separate the annual financial provision under subhead 367 (salaries and allowances for staff and general expenses of the LCC) into different components. Separate "funding for cash allowance" did not exist; and

- setting aside the conceptual disagreement as to whether there was any over-provision, the so-called "over-provision" of $30.5 million amounted to only 1.6% of the total provision under subhead 367 in the nine years between 1994-95 and 2002-03 (the total provision was $1,863.4 million). As funding for cash allowance was not itemised, there was no question of "over provision" of funding for cash allowance.

47. In response to the views of the Secretary for Financial Services and the Treasury and the Secretary General of the LCS on the provision of funding for cash allowance, the Director of Audit offered detailed comments in his letters of 24 June 2003 (in ***Appendix 28***), 25 June 2003 (in ***Appendix 29***) and 26 June 2003 (in ***Appendix 30***). In short, the **Director of Audit** said that:

- Audit's evidence showed that the LCS had all the details of the reduction in funding requirements for cash allowance due to the decrease in CARs and the fact that some staff of the LCS chose not to receive the cash allowance. The actual funding requirements for cash allowance were, in fact, reflected in the LCC's budget which included breakdown of expenditure submitted to the FSTB every year. The FSTB would not have over-provided funds to the LCC, if it had adjusted the funding to the LCC for cash allowance according to the LCC's budget;

- as the LCS had full details of the actual funding requirements for cash allowance and such details were submitted to the FSTB every year, there would not be any extra work for the LCS or the FSTB to keep track of the actual requirements for cash allowance;

- according to paragraph 3.2 of the EoL, the provision to the LCC would be increased where additional funds were required to meet the cost of cash allowance in accordance with the CARs. However, if the funds provided exceeded the requirement in respect of cash allowance in accordance with the CARs, it was only reasonable and logical to expect that the funding would be reduced. Therefore, the FSTB should have adjusted the funding to the LCC for cash allowance to take into account the reduction in funding 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; and

- under normal circumstances, the LCC might not need to segregate and earmark money for different expenditure components. However, when there were significant changes in circumstances, the funding requirements must be re-assessed. At these times, thorough vetting by the FSTB was necessary on the expenditure components to ensure the adequacy and reasonableness of funding. Without this basic funding control, the OLV funding arrangement would be deficient and could get out of control.

48. As regards funding for contract gratuities for new posts and posts not filled by contract staff, the Committee noted Audit's observations in paragraph 4.16 that in respect of the new posts creating during 1996-97 to 1998-99, the percentages of the annual contract gratuities included in the funding to the LCC had been wrongly calculated and, in most cases, a double provision (i.e. additional 85% per year) for such posts had been made. Audit also stated in paragraph 4.17 that the FSTB should not have provided funding to the LCC for contract gratuities for the posts which were not filled by contract staff.

49. Against the above background, the Committee enquired whether the FSTB had discovered and brought up the following circumstances for discussion with the LCC:

- the LCS's annual submissions since 1997-98 had included 100% (instead of 15%) of the contract gratuities in respect of the new posts created during 1996-97 to 1998-99; and

- the LCS's submission in May 1995 had included the contract gratuities for posts that were not filled by contract staff.

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50. Regarding the calculation of funding requirement of contract gratuities in respect of the new posts supported during 1996-97 to 1998-99 and in respect of posts not filled by contract staff during April 1994 to April 1995, the **Secretary for Financial Services and the Treasury**, in his letters of 17 June 2003 and 25 June 2003, advised that:

- the FSTB had no records of discussion with the LCS on such issues. This was also because of the OLV concept and method. The agreed method for determining the funding for contract gratuities for inclusion into the OLV was the "three-year funding cycle". It represented a broadbrush approach, using projected establishment as the basis for projecting the funding to be included for contract gratuities;

- allocation under the Resource Allocation Exercise (RAE) was a separate funding process. The allocation provided under the RAE represented the resources supported for providing additional services or enhancing existing ones. In line with general practice, for successful bids for resources from the LCC, the FSTB used the full-year salary, cash allowance and 100% of the year's contract gratuity as a reference to calculate the resources required for supporting the new services or improved services. Upon RAE allocation, the LCC was free to deploy the resources supported in the most economical way as it saw fit so long as the services were provided as specified in the resource bid;

- according to the "three-year funding cycle" method:

  (a) the provisions for contract gratuity for 1994-95 and 1995-96 had been 15% respectively of the projected yearly contract gratuities of the estimated staff establishment of 280 for 1994-95; and

  (b) in addition to the 15% mentioned above, a provision of 255% of the projected contract gratuities of the estimated staff establishment of 286 for 1995-96 (the latest establishment estimate available when preparing the 1996-97 baseline in May 1995) had been added to the provision; and

- under this method, there was no need to adjust the funding for gratuities to the LCC to reflect changes in actual requirements, such as whether contract staff had replaced civil servants seconded to the LCC or whether there were vacant posts during 1994-95. To do so would be inconsistent with the OLV funding arrangement. If the FSTB compared the actual expenditure of the LCC with the funding of a specific component and claw back underspending, it could be argued that the FSTB should also provide additional funds in case the actual expenditure on a component was larger than the level included for the component in the block grant. It would defeat the purpose of the OLV for the organisation to flexibly redeploy resources between components of expenditure.

51. The Committee asked whether the LCC would, in the light of Audit's observations on the provision for the LCC for contract gratuities in respect of the new posts created during 1996-97 to 1998-99, reduce its funding requests for the coming financial year by the amount which, according to Audit, had been "over-provided".

52. In his letter of 14 June 2003, the **Secretary General of the LCS** replied that:

- the LCC's funding request for the coming financial year would not be reduced as recommended by Audit, because the funding so far provided for the LCC had been made in accordance with the arrangements mutually agreed between the Administration and the LCC; and

- the funding requests made by the LCC and agreed to by the Administration were not in respect of **posts** to be created but in respect of **services** to be provided or enhanced. The funds finally provided for the LCC were not itemised for specific components, and not even allocated separately for staff emoluments and general expenses. Consequently, the number of posts and the levels of staff employed at a certain point in time had no direct relationship with an earlier funding application and the subsequent allocation. Therefore, the question of incorrect calculation or over-provision of funds in respect of those posts created during the years 1996-97 to 1998-99 did not arise.

53. Referring to the statement of the Secretary General of the LCS that the LCC's funding requests were not in respect of posts to be created but in respect of services to be provided or enhanced, the Committee enquired:

- about the basis of the statement;

- about the information provided by the LCC to the FSTB to support funding applications in respect of existing and new or enhanced services; and

- whether cash allowance and contract gratuity for staff were relevant information in the LCC's funding applications.

54. The **Secretary General of the LCS**, in his letter of 19 June 2003 in ***Appendix 31***, explained that:

<u>Funding requests in respect of services</u>

- to ensure the managerial and financial autonomy of the LCC, the Administration did not control the staff establishment of the LCC or the way the LCC delivered its services. Requests for additional funding in each RAE were in respect of new or improved services, and not for the creation of posts. This conceptual framework was laid down in the EoL. Paragraphs 4 and 5 of the EoL were particularly relevant;

- new funds were not earmarked for any posts, and the LCC had the freedom to deploy new resources allocated through an RAE. This was illustrated by the notification of funding application results from the Secretary for Financial Services and the Treasury;

<u>Supporting information for the FSTB in relation to funding applications</u>

- the funding for existing services was based on the approved financial provision for the LCC's recurrent expenses in the previous year (i.e. baseline expenditure);

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

<u>Relevance of cash allowances and contract gratuity in funding applications</u>

- funding for existing services did not take into account the amount of cash allowances and contract gratuities payable by the LCC. Such funding was based on the financial provision approved in the previous year; and

- regarding funding requests for new or improved services, if the plan was to employ additional staff, the estimated staff costs would be used for budgeting the resources required. Salary, cash allowance and contract gratuity involved were taken into account in estimating the staff costs. However, the LCC's funding requests were in respect of the overall cost for the new or improved services, and not for any specific components.

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55. On the question of whether the funding allocated to the LCC under the RAE was in respect of services to be provided/enhanced or posts to be created, the **Director of Audit**, in his letter of 19 June 2003 in ***Appendix 32***, commented 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; and

- although the funds finally provided for the LCC had not been itemised for specific components, the amount of funds to be allocated was derived by adding together specific components, including cash allowance and 100% of contract gratuities for the new posts. As pointed out in paragraph 4.20(c) of the Audit Report, Audit observed that, notwithstanding that full funding for contract gratuities for the new posts had already been included in the normal funding, the LCS had subsequently made a double request for the funding for 85% of contract gratuities per year for such posts.

56. The Committee asked the FSTB whether:

- it allocated funding for new or enhanced services to the LCC in terms of posts or services; and

- the components of cash allowance and contract gratuity were relevant to its consideration of the LCC's funding applications in respect of existing and new or enhanced services.

57. In his letter of 19 June 2003, in ***Appendix 33***, the **Secretary for Financial Services and the Treasury** advised that:

- the funding allocated to the LCC under the RAE process represented the resources supported for new or enhanced services. The resources allocated became part of the OLV and the LCC had the flexibility to deploy funds among expenditure components in the most economical way as it saw fit, so long as the services were provided as specified in the LCC's resource bid. Furthermore, as the LCC was not under the Administration's establishment controls, it determined the staff mix, ranks and grades, and number of posts at its own discretion and had the flexibility to create or delete posts to suit its operational expedience; and

- when the LCC submitted bids for new resources, apart from justifications for the bids, the amount of new money requested would have to be supported by cost estimates. These might be expressed in terms of staff cost and other day-to-day operational expenses. Staff cost data might include salaries and other salary-related costs such as cash allowance and contract gratuity. All these cost estimates would be taken into account in assessing the amount of resources to be allocated. However, once the new resources had been allocated for a particular new or enhanced service, the resources formed part of the OLV and there was no requirement that the LCC must spend the resources allocated in accordance with the cost estimates in the resource bid.

58. To ascertain whether the LCC had used appropriate percentages in applying for funds for contract gratuities in respect of the new posts in question, the Committee enquired:

- about the correct percentage of contract gratuities that, in the LCC's opinion, should be included in the normal funding to the LCC; and

- whether the LCC agreed that when new resources were allocated according to the estimated staff costs, such new resources had already included a provision to cover the contract gratuities required. Hence, there was no need to request funds for contract gratuities in addition to the new resources approved in the RAE.

59. In his letter of 24 June 2003, the **Secretary General of the LCS** responded that:

- in order to reflect the true cost implications of a new service, the LCC considered that the estimated total cost should be used in funding applications;

- if it was planned that the new service for which new resources were applied was to be provided by additional staff, the new resources allocated would include a provision to cover an element of contract gratuities. However, the decision of whether to employ additional staff to implement the new service in question or what staff should be employed to implement the new service would depend on prevailing circumstances. Therefore, whether and how much of the new resources allocated would be used to pay contract gratuities would depend on how the new service was to be delivered; and

- the application for resources to pay contract gratuities was made according to the funding mechanism agreed between the Administration and the LCC. Under the agreed mechanism, funds applied for were based on the staff establishment of the LCS at the beginning of the second year of the three-year contract gratuity funding cycle and were not **directly related** to the new resources approved in the RAEs.

60. The Committee noted that in the notification to the LCC for the new resources allocated in the 1997 RAE for 1998-99 (i.e. the then Secretary for the Treasury's letter of 23 August 1997 in ***Appendix 34***), it was stated that should the Secretary General of the LCS "redeploy resources from the bids supported by Star Chamber to other purposes, you will not normally be allowed to repeat the request for funds for the same purpose in subsequent years". On the other hand, paragraph 4.3 of the Audit Report revealed that 100% of the annual contract gratuities for the new posts created after 1994-95 had been included in the normal funding to the LCC and, for the third year of the funding cycle, an additional amount equalled to 255% of the year's contract gratuities had been further provided to the LCC 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).

61. The Committee asked whether the LCC agreed:

- that the request for the 255% of the year's contract gratuities in respect of the new posts was a request for funds for the same purpose; and

- to Audit's view that it had made double requests for the funding for 85% of contract gratuities per year for the new posts created during the years 1996-97 to 1998-99.

62. The **Secretary General of the LCS**, in his letter of 24 June 2003, replied that:

- according to the funding mechanism for staff contract gratuities agreed with the Administration, the 255% (85% + 85% + 85%) funding for contract gratuities requested in the third year of each three-year contract gratuity funding cycle was applied en bloc to the total projected salaries for permanent posts in the establishment in the second year of the cycle. The year in which the posts were created was not relevant to the calculation of the remaining funding, because the number and grading of posts might vary in the course of time as circumstances dictated and might be completely different from the implementation plans prepared at the funding application stage;

- obtaining the 255% cycle-end funding was in accordance with the funding mechanism agreed with the Administration. It was not an application for new resources and was not made in relation to any specific posts supported in a particular RAE. The LCC did not therefore accept that it was a request for funds for the same purpose. It should be pointed out that the then Secretary for the Treasury's advice that repeating a request for funds for the same purpose was not allowed in subsequent years meant that the LCC was not allowed to ask for funds again to deliver **the same service**; and

- the funding request for 85% of contract gratuities per year for the posts created in previous years was in accordance with the funding mechanism agreed with the Administration. Therefore, there was no question of the LCC making double requests for funding of contract gratuities.

63. On the question of whether the LCC had made double requests for funds in respect of contract gratuity, the **Director of Audit**, in his letters of 24 and 25 June 2003, stated that:

- while the LCC's funding requests were in respect of the overall cost for the new or improved services, and not for any specific components, it was an undeniable fact that the funds allocated in RAEs for the new posts created during the period 1996-97 to 1998-99 had 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 funds for contract gratuities; and

- in Audit's view, 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 was a duplication of the request for funds for the same purpose. This was because the posts concerned provided the same service as the service which was used to justify the creation of such posts in the RAE.

64. In his letters of 24, 25 and 26 June 2003, the **Director of Audit** informed the Committee of his consolidated views on the OLV funding arrangement and the allocation of funds to the LCC for cash allowance and contract gratuity. He stated that:

- Audit was fully aware that the OLV funding arrangement for the LCC provided flexibility in the deployment of resources while recognising the special status of the Legislature. Audit appreciated the merits of flexibility in the deployment of resources under such an arrangement. However, Audit maintained 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, including the OLV arrangement, was a control over the actual funding requirements at the inception of the arrangement and at times when there were significant changes in circumstances. At such times, thorough vetting by the Administration was necessary on the expenditure items to ensure that the funding was reasonable and adequate but was not more than that required by the LCC;

- under the OLV funding arrangement:

  (a) funds were not segregated and earmarked for individual expenditure components such as cash allowance and contract gratuity; and

  (b) government provision to the LCC for its recurrent expenditure for each financial year was 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;

- ascertaining the actual funding requirements was an essential control which should be incorporated into any funding scheme, including the OLV arrangement. The deficiency of the OLV arrangement for the LCC was that the Administration had not exercised the basic funding control by ascertaining the LCC's actual funding requirements for cash allowance and contract gratuity. This had resulted in the over-provision of funding to the LCC; and

- as stated in paragraph 1.14 of the Audit Report, there was a mechanism whereby the FSTB would provide additional funds to the LCC in case the funding requirement on an expenditure component (such as cash allowance and contract gratuity) was larger than the funding for the expenditure component included in the OLV. However, there was no mechanism for the

FSTB to reduce the provision to the LCC if the funding requirement on an expenditure component was smaller than the funding for the expenditure component included in the OLV. This was clearly an unsatisfactory funding arrangement.

65. To better understand how the FSTB exercised basic control in the OLV system, the Committee asked, under the OLV funding arrangement:

- whether the FSTB reviewed the LCC's budget which contained the breakdown of expenditure to ascertain if there were any significant changes in the actual funding requirements of the LCC's individual expenditure components;

- how the FSTB prevented over-provision of funding to the LCC's individual expenditure components; and

- whether the FSTB agreed that if the information provided by the LCC was not reviewed periodically, basic control over the level of provision to the LCC was lost and the OLV arrangement could get out of control.

66. In his letter of 25 June 2003, the **Secretary for Financial Services and the Treasury** advised that:

- under the EoL, the Secretary General of the LCS prepared the LCC's annual draft estimates of expenditure for inclusion in the Government's draft annual Estimates of Expenditure. For the purpose of these estimates, since, under *Head 112 Legislative Council Commission*, the relevant subhead (previously *Subhead 367 Salaries and allowances for staff and general expenses*, and in the 2003-04 Estimates *Subhead 000 Operational Expenses*) was not broken down into components such as salaries or cash allowance, strictly speaking there was no need for the LCC to supply such breakdown to the Government. There was no express requirement for such information in the EoL. In practice, however, the LCC provided the Government with its own budgets for information, which were broken down into components;

- under the agreed funding method, the LCC was not subject to the Government's financial control at the level of expenditure components. Therefore, the FSTB did not seek and use information on the LCC's finances (e.g. in its own budget, or in its annual accounts tabled in the LegCo) **for the purpose** of preventing "over-provision" to the LCC's individual expenditure components. But it did use the LCC's financial information in other contexts, e.g. the baseline-plus exercise, or the RAE if the LCC bid for new resources;

- if appropriate, the FSTB's information on the LCC's financial position might be relevant when, e.g. it processed the LCC's RAE bids. In the past years, the Government had decided not to fund some of the LCC's bids, or fund only partially some other bids; and

- as for the scenario of the funding arrangement for the LCC getting out of control, the FSTB envisaged that with the information it maintained on the LCC's finances, it 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 envisaged that for its part, the LCC would exercise its statutory autonomy responsibly so that the situation would not get out of hand. Conversely, the FSTB did not think it necessary for the Government to maintain component-by-component control over the LCC in order to prevent such a scenario.

67. **Conclusions and recommendations** The Committee:

- acknowledges that:

  (a) The Legislative Council Commission (the LCC) is given financial and managerial autonomy under The Legislative Council Commission Ordinance and the funding arrangement for the LCC is laid down in the Exchange of Letters (EoL) signed between the Administration and the LCC; any amendments to the EoL have to be mutually agreed;

  (b) as agreed between the LCC and the Administration, funding to the LCC is in the form of a one-line vote (OLV) and not broken down into components of expenditure. Under such an arrangement, the LCC has the autonomy and flexibility in deploying funds among types of expenditure, and its components of expenditure are not subject to the Administration's control; and

  (c) the Administration does not prescribe the components of expenditure of the LCC. If the LCC spends more or less on a particular component, the Administration does not provide additional funds to meet the shortfall or claw back any surplus;

- expresses concern that:

  (a) since 1994, the funding for staff emoluments and general expenses of the LCC has been greater than its actual requirement, leading to the rapid build-up of the LCC's reserve; and

  (b) the LCC, in offering 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 Financial Services and the Treasury Bureau's (FSTB's) guidelines, had not taken into account the continuous rapid changes in employment market situations after the last review in 1999;

- notes that the OLV funding arrangement as is presently designed has partly contributed to the surpluses of funding for staff emoluments and general expenses because it had failed to recognise the following:

  (a) the significant decrease in cash allowance rates during the period 1994-95 to 2002-03 and the reduction in the LCC's funding requirements as some staff of the Legislative Council Secretariat (LCS) chose not to receive the cash allowance;

  (b) the LCS's annual submissions since 1997-98 had included 100% (instead of 15%) of the contract gratuities in respect of the new posts created during 1996-97 to 1998-99; and

  (c) the LCS's submission in May 1995 had included the contract gratuities for posts that were not filled by contract staff during the period April 1994 to April 1995;

- considers that:

  (a) although the LCC enjoys a high degree of financial autonomy, it should follow as closely as possible the guidelines on the best management practices as provided in the Finance Bureau Circular Memorandums (FBCMs), and any decision to deviate from the guidelines should be made with strong justifications;

  (b) the LCC should specifically inform the FSTB of material deviations from the guidelines in the FBCMs and consider establishing a suitable avenue to explain such deviations publicly;

(c) under the OLV funding arrangement, where the funding to the LCC has been surplus to requirements and no fundamental review has been carried out over a long period of time to ascertain the LCC's actual requirements, this could lead to the build-up of a substantial amount of reserve by the LCC which cannot be justified by its expenditure requirements within a reasonable time frame; and

(d) the LCC should exercise its statutory autonomy responsibly so that the situation would not get out of control;

- acknowledges that:

  (a) the LCC had decided on 20 May 2003 to lower the rate of contract gratuity for newly recruited non-professional and supporting staff to 10% of their basic salary; and

  (b) the LCC had resolved on 24 October 2002 that it would fund the operation of future select committees from its reserve in order to reduce the Government's expenditure;

- notes that:

  (a) while some subvented organisations' reserve is subject to a ceiling, there are exceptions to the rule, such as the Office of The Ombudsman, Consumer Council, Hong Kong Trade Development Council, Equal Opportunities Commission, and Office of the Privacy Commissioner for Personal Data; and

  (b) if a ceiling is to be set for the LCC's reserve, the EoL needs to be amended with the mutual agreement of the LCC and the Administration;

- recommends that the Secretary for Financial Services and the Treasury should discuss with the LCC whether or not a ceiling for the LCC's reserve should be set, having regard to the following:

  (a) the constitutional status of the Legislature;

  (b) the long-standing policy to accord the LCC financial autonomy;

  (c) some subvented organisations do not have a ceiling set for their reserve; and

(d) the LCC's operational needs, its past spending pattern, its decision to fund the operation of future select committees from its reserve and other possible uses of its reserve;

- recommends that the LCC should:

  (a) in the light of its substantial reserve, provide to the FSTB justifications for maintaining a reserve at such a level vis-à-vis its future expenditure requirements;

  (b) if it agrees to set a ceiling for its reserve, and at the end of a financial year the level of reserve exceeds the ceiling, return the excess amount to the Government; or

  (c) if it is agreed not to set a ceiling for its reserve and its reserve level is higher than future expenditure and contingency requirements, consider making a voluntary offer to make a one-off payment of the excess amount to the Government; and

- wishes to be kept informed of the discussion between the FSTB and the LCC on the setting of a ceiling for the LCC's reserve.